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Washington, Saturday, February 11, 1939

The President

EXECUTIVE ORDER

AUTHORIZING THE APPOINTMENT OF FREDERICK MORGAN DAVENPORT TO A CLASSIFIED POSITION IN THE CIVIL SERVICE COMMISSION AND DESIGNATING HIM AS A MEMBER AND CHAIRMAN OF THE COUNCIL OF PERSONNEL ADMINISTRATION

By virtue of and pursuant to the authority vested in me by paragraph Eighth, subdivision SECOND, section 2 of the Civil Service Act (22 Stat. 403, 404), and as President of the United States, it is hereby ordered that Frederick Morgan Davenport may be appointed to a classified position in the Civil Service Commission; and I hereby designate the said Frederick Morgan Davenport as a member and Chairman of the Council of Personnel Administration established by section 7 of Executive Order No. 7916 of June 24, 1938,[1] such designation to become effective upon his acceptance of the appointment herein authorized.

FRANKLIN D ROOSEVELT

THE WHITE HOUSE
February 8, 1939.

[No. 8045]

[F. R. Doc. 39-476; Filed, February 9, 1939; 2:49 p. m.]

Rules, Regulations, Orders

TITLE 16—COMMERCIAL PRACTICES

FEDERAL TRADE COMMISSION

[Docket No. 3232]

IN THE MATTER OF AMERICAN OPTICAL COMPANY ET AL.

SEC. 3.45 (e) (2) *Discriminating in price — Indirect discrimination — Cumulative discounts.* — Discriminating in price, in connection with distribution and sale of optical and ophthalmic products in commerce between the states and in District of Columbia, and on the part of respondent association and respondent corporation, their officers, etc., between different purchasers of such products of like grade and quality, by (a) granting or allowing, under respondents' "big dealer" (retailer) discount plan, cumulative or volume discounts on stock lenses, frames and mountings (items or types in greatest demand and making up bulk of purchases of respondents' customers), on basis certain monthly or yearly aggregate purchases of all items included, whether themselves subject or not to such discounts, and irrespective of size or number of orders thus aggregated, and including among said items last referred to as not themselves subject to such discounts, prescription purchases and purchase of machinery and ophthalmological equipment; or by (b) continuing in effect, as described, respondents' "big dealer" (retailer) discount plan, differentials of which plan failed to make only due allowances for or to bear any consistent relation to differences, if any, in cost of sale or delivery of stock merchandise resulting from the differing quantities in which sale and delivery is made to different customers under said plan; with result that, while substantial number of respondents' customers were able to secure discounts provided in their "big dealer" discount schedule, many other customers, engaged in competition with such "big dealers" in use and sale of respondents' said products, did not receive benefit of such discounts, and with result that effect of such discrimination in price had been to injure and might be to injure, destroy or prevent competition with respondents' retailer customers receiving benefit of such discrimination, and effect thereof was and might be substantially to lessen competition or tend to create a monopoly in the line of commerce in which respondents were engaged, or to injure, destroy or prevent competition with respondents in both the wholesale and manufacturing fields; prohibited. (Sec. 2 (a), 59 Stat. 1526; 15 U. S. C., Supp. IV, Sec. 13 (a))

[Cease and desist order, American Op-

[1] 3 F. R. 1526 DI.

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RULES, REGULATIONS, ORDERS

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FEDERAL REGISTER

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tical Company et al., Docket 3232, January 21, 1939]

SEC. 3.45 (e) (2) *Discriminating in price—Indirect discrimination—Cumulative discounts.* Discriminating in price, in connection with distribution and sale of optical and ophthalmic products in commerce between the states and in District of Columbia, and on the part of respondent association and respondent corporation, their officers, etc., between purchasers of ophthalmic stock merchandise and equipment who also purchase merchandise from respondents on prescriptions for single pairs of glasses, or employ respondents to fill such prescriptions, and other purchasers of such merchandise and equipment who do not purchase from respondents on prescriptions or employ respondents to fill prescriptions, unless such price differences make only due allowance for differences in cost of selling or delivering such stock merchandise and equipment to such purchasers resulting from the differing methods or quantities in which such stock merchandise and equipment is sold and delivered, prohibited; subject to provision that such prohibition shall not be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law. (Sec. 2 (a) 59 Stat. 1526; 15 U. S. C., Supp. IV, sec. 13 (a)) [Cease and desist order, American Optical Company et al., Docket 3232, January 21, 1939]

Sec. 3.45 (e) (2) *Discriminating in price—Indirect discrimination—Cumulative discounts.* Discriminating in price, in connection with distribution and sale of optical and ophthalmic products in commerce between the states and in District of Columbia, and on the part of respondent association and respondent corporation, their officers, etc., between different purchasers of such products of like grade and quality by granting or allowing any other cumulative or volume discounts, rebates or price reductions, where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in a line of commerce in which respondents or their customers are engaged, or to injure, destroy or prevent competition with respondents or with any of their customers, except where such discounts, rebates or price reductions make only due allowance for differences in cost resulting from the differing methods or quantities in which such products are to such purchasers sold and delivered during the period of time for which such discounts, rebates or price reductions are granted or allowed, prohibited; subject to provision that such prohibition shall not be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law. (Sec. 2 (a), 59 Stat. 1526; 15 U. S. C. Supp. IV, sec 13 (a)) [Cease and desist order, American Optical Company et al., Docket 3232, January 21, 1939]

United States of America—Before Federal Trade Commission

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 21st day of January, A. D. 1939.

Commissioners: Robert E. Freer, Chairman; Garland S. Ferguson, Charles H. March, Ewin L. Davis, William A. Ayres.

IN THE MATTER OF AMERICAN OPTICAL COMPANY, A VOLUNTARY ASSOCIATION AND ALL ITS MEMBERS; GEORGE B. WELLS, INDIVIDUALLY AND AS PRESIDENT OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; IRA MOSHER, INDIVIDUALLY AND AS VICE PRESIDENT AND GENERAL MANAGER OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; CHARLES O. COZZENS, INDIVIDUALLY AND AS VICE PRESIDENT IN CHARGE OF SALES OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; JOHN M. WELLS, INDIVIDUALLY AND AS VICE PRESIDENT IN CHARGE OF RESEARCH LABORATORY OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; EDWARD E. WILLIAMS, INDIVIDUALLY AND AS TREASURER OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; A. TURNER WELLS, INDIVIDUALLY AND AS SECRETARY OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; ALBERT B. WELLS, INDIVIDUALLY AND AS CHAIRMAN OF THE BOARD, AND AS REPRESENTATIVE OF THE BOARD OF DIRECTORS OF AMERICAN OPTICAL COMPANY, AN ASSOCIATION; AND AMERICAN OPTICAL COMPANY, A CORPORATION, RESPONDENTS

ORDER TO CEASE AND DESIST

This proceeding having been heard[1] by the Federal Trade Commission upon the complaint of the Commission, the joint answer of the respondents, and a stipulation as to the facts signed by counsel for the Commission and counsel for the respondents in which it is provided that the statement of facts contained therein may be accepted as the facts in this proceeding in lieu of testimony in support of the charges stated in the complaint and in opposition thereto, and the taking of testimony and all intervening procedure having been waived, and the Commission being of the opinion that said respondents have violated the provisions of Section 2 (a) of an Act of Congress approved October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (the Clayton Act), as amended, and having made its report stating its findings as to the facts, which report is made a part hereof,

It is ordered, That the respondents, American Optical Company, an association, and American Optical Company, a corporation, and their respective officers, members, representatives, agents and employees, in connection with the distribution and sale of optical and ophthalmic products in commerce between the states and in the District of Columbia, do forthwith cease and desist

1. From discriminating in price between different purchasers of such products of like grade and quality, either directly or indirectly, by granting or allowing the cumulative or volume discounts described in Paragraph Seven of said Findings as to the Facts, or by continuing in effect the "big dealer" discount plan in said paragraph described.

2. From discriminating in price between purchasers of ophthalmic stock merchandise and equipment who also purchase merchandise from respondents on prescriptions for single pairs of glasses, or employ respondents to fill such prescriptions, and other purchasers of such merchandise and equipment who do not purchase from respondents on prescriptions or employ respondents to fill prescriptions, unless such price differences make only due allowance for differences in cost of selling or delivering such stock merchandise and equipment to such purchasers resulting from the differing methods or quantities in which such stock merchandise and equipment is sold and delivered.

3. From discriminating in price between different purchasers of such products of like grade and quality by granting or allowing any other cumulative or volume discounts, rebates or price reductions, where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in a line of commerce in which respondents or their customers are engaged, or to injure, destroy or prevent competition with respondents or with any of their customers, except where such discounts, rebates or price reductions make only due allowance for differences in cost resulting from the differing methods or quantities in which such products are to such purchasers sold and delivered during the period of time for which such discounts, rebates or price reductions are granted or allowed.

Nothing contained in paragraphs 2 or 3 hereof shall be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law.

It is further ordered that said respondents, within sixty days after service upon them of this Order, shall file with the Commission a report in writing setting forth in detail the manner and form in which they have complied and are complying with this Order.

By the Commission.

[SEAL] OTIS B. JOHNSON, *Secretary.*

[F. R. Doc. 39-477; Filed, February 9, 1939; 3:35 p. m.]

[1] 3 F. R. 2315 DI.

[Docket No. 3233]

IN THE MATTER OF BAUSCH & LOMB OPTICAL COMPANY, ET AL.

SEC. 3.45 (e) (2) *Discriminating in price—Undue discrimination—Cumulative discounts.* Discriminating in price, in connection with distribution and sale of optical and opthalmic products in commerce between the states and in the District of Columbia, and on the part of respondent manufacturer, distributor and seller, and respondent wholesalers, its selling affiliates (majority voting stock of which it controls, and selling policies of which are coordinated by it), their officers, etc., between different purchasers of such products of like grade and quality, by (a) granting or allowing, under their "big dealer" (retailer) discount plan, cumulative or volume discounts on stock lenses, frames and mountings (items or types in greatest demand and making up bulk of purchases of the optical retailers), on basis certain monthly or yearly aggregate purchases of all items included, whether themselves subject or not to such discounts, and irrespective of size or number thus aggregated, and including among items referred to as not themselves subject to such discounts, prescription purchases, "net" items, and purchases of machinery, or by (b) continuing in effect, as described, their said "big dealer" (retailer) discount plan, differentials of which fail to bear any consistent relation to size of single orders or differences in cost of sale and delivery per dollar of merchandise as between different purchasers, or to make only due allowance for differences, if any, in cost of sale or delivery resulting from differing methods or quantities in which sale and delivery is made to different purchasers under said plan; with result that small optometrists and opticians did not receive such discounts and could not purchase in sufficient volume to qualify for them, they discriminated in price in favor of a substantial number of their larger customers, and effect of such discrimination in price had been to injure, and might be to injure, destroy or prevent competition with their customers receiving benefit of such discrimination, and was, and might be, substantially to lessen competition or tend to create a monopoly in the lines of commerce in which they were respectively engaged, and to injure, destroy or prevent competition with them by other wholesalers, and with respondent manufacturer, distributor and seller, by limited line manufacturers of optical goods; prohibited. (Sec. 2 (a), 59 Stat. 1526; 15 U. S. C., Supp. IV, sec. 13 (a)) [Cease and desist order, Bausch & Lomb Optical Company et al., Docket 3233, January 21, 1939]

SEC. 3.45 (e) (2) *Discriminating in price—Undue discrimination—Cumulative discounts.* Discriminating in price, in connection with distribution and sale of optical and ophthalmic products in commerce between the states and in the

District of Columbia, and on the part of respondent manufacturer, distributor and seller, and respondent wholesalers, its selling affiliates (majority voting stock of which it controls, and selling policies of which are coordinated by it), their officers, etc., between purchasers of ophthalmic stock merchandise and equipment who also purchase merchandise from respondents on prescriptions for single pairs of glasses, or employ respondents to fill such prescriptions, and other purchasers of such merchandise and equipment who do not purchase from respondents on prescriptions or employ respondents to fill prescriptions, unless such price differences make only due allowance for differences in cost of manufacturing, selling or delivering such stock merchandise and equipment to such purchasers resulting from the differing methods or quantities in which such stock merchandise and equipment is sold and delivered, prohibited; subject to provision that such prohibition shall not be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law. (Sec. 2 (a), 59 Stat. 1526; 15 U. S. C., Supp. IV, sec. 13 (a)) [Cease and desist order, Bausch & Lomb Optical Company et al., Docket 3233, January 21, 1939]

SEC. 3.45 (e) (2) *Discriminating in price—Undue discrimination—Cumulative discounts.* Discriminating in price, in connection with distribution and sale of optical and ophthalmic products in commerce between the states and in the District of Columbia, and on the part of respondent manufacturer, distributor and seller, and respondent wholesalers, its selling affiliates (majority voting stock of which it controls, and selling policies of which are coordinated by it), their officers, etc., between different purchasers of such products of like grade and quality by granting or allowing any other cumulative or volume discounts, rebates or price reductions, where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in a line of commerce in which respondents or their customers are engaged, or to injure, destroy or prevent competition with respondents or with any of their customers, except where such discounts, rebates or price reductions make only due allowance for differences in cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such products are to such purchasers sold and delivered during the period of time for which such discounts, rebates or price reductions are granted or allowed, prohibted; subject to provision that such prohibition shall not be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law. (Sec. 2 (a), 59 Stat. 1526; 15 U. S. C., Supp. IV, sec. 13 (a)) [Cease and desist order, Bausch & Lomb Optical Company et al., Docket 3233, January 21, 1939]

United States of America—Before Federal Trade Commission

At a regular session of the Federal Trade Commission held at its office in the City of Washington, D. C., on the 21st day of January, A. D. 1939.

Commissioners: Robert E. Freer, Chairman; Garland S. Ferguson, Charles H. March, Ewin L. Davis, William A. Ayres.

IN THE MATTER OF BAUSCH & LOMB OPTICAL COMPANY, A CORPORATION, COLONIAL OPTICAL COMPANY, INC., A CORPORATION, MCINTIRE, MAGEE & BROWN COMPANY, A CORPORATION, RIGGS OPTICAL COMPANY CONSOLIDATED, A CORPORATION, RIGGS OPTICAL COMPANY, INC., A CORPORATION, SOUTHEASTERN OPTICAL COMPANY, A CORPORATION, AND THE WHITE-HAINES OPTICAL COMPANY, A CORPORATION, RESPONDENTS

ORDER TO CEASE AND DESIST

This proceeding having been heard [1] by the Federal Trade Commission upon the complaint of the Commission, the separate answers of the respondents, and a stipulation as to the facts signed by counsel for the Commission and counsel for all of the respondents in which it is provided that the statement of facts contained therein may be accepted as the facts in this proceeding in lieu of testimony in support of the charges stated in the complaint and in opposition thereto, and the taking of testimony and all intervening procedure having been waived, and the Commission being of the opinion that said respondents have violated the provisions of Section 2 (a) of an Act of Congress approved October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (the Clayton Act), as amended, and having made its report stating its findings as to the facts, which report is made a part hereof.

It is ordered, That the respondents, Bausch & Lomb Optical Company, Colonial Optical Company, Inc., McIntire, Magee & Brown Company, Riggs Optical Company Consolidated, Riggs Optical Company, Inc., Southeastern Optical Company, and The White-Haines Optical Company, and their respective officers, representatives, agents and employees, in connection with the distribution and sale of optical and ophthalmic products in commerce between the states and in the District of Columbia, do forthwith cease and desist:

1. From discriminating in price between different purchasers of such products of like grade and quality, either directly or indirectly, by granting or allowing the cumulative or volume discounts described in paragraph Fourteen or said Findings as to the Facts, or by continuing in effect the "big dealer" discount plan in said Paragraph described.

2. From discriminating in price between purchasers of ophthalmic stock merchandise and equipment who also purchase merchandise from respondents on prescriptions for single pairs of glasses, or employ respondents to fill such prescriptions, and other purchasers of such merchandise and equipment who do not purchase from respondents on prescriptions or employ respondents to fill prescriptions, unless such price differences make only due allowance for differences in cost of manufacturing, selling or delivering such stock merchandise and equipment to such purchasers resulting from the differing methods or quantities in which such stock merchandise and equipment is sold and delivered.

3. From discriminating in price between different purchasers of such products of like grade and quality by granting or allowing any other cumulative or volume discounts, rebates or price reductions, where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in a line of commerce in which respondents or their customers are engaged, or to injure, destroy or prevent competition with respondents or with any of their customers, except where such discounts, rebates or price reductions make only due allowance for differences in cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such products are to such purchasers sold and delivered during the period of time for which such discounts, rebates or price reductions are granted or allowed.

Nothing contained in paragraphs 2 or 3 hereof shall be construed to prevent said respondents from showing that any such discount, rebate or other price reduction made or offered to be made by them was given in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor, or from granting any discounts, rebates or price reductions permitted by law.

It is further ordered that each of said respondents, within sixty days after

[1] 2 F. R. 2085 (2433 DI).

service upon them of this Order, shall file with the Commission a report in writing setting forth in detail the manner and form in which it has complied and is complying with this Order.

By the Commission.

[SEAL] OTIS B. JOHNSON, *Secretary.*

[F. R. Doc. 39-478; Filed, February 9, 1939; 3:36 p. m.]

TITLE 17—COMMODITY AND SECURITIES EXCHANGES

SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933—SECURITIES EXCHANGE ACT OF 1934

ADOPTION OF RULE S-827 AND AMENDMENT NO. 33 TO INSTRUCTION BOOK FOR FORM A-2

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Act of 1933, as amended, particularly Sections 10 (b) and 19 (a) thereof, and finding that such action is necessary and appropriate in the public interest and for the protection of investors hereby takes the following action:

1. The following new rule is adopted:

SEC. 5.S-827 (Rule S-827). *Statement required in prospectuses relative to stabilizing.*—In any case in which the registrant or any of the underwriters knows or has reasonable grounds to believe that it is intended to stabilize the price of any security to facilitate the offering of the registered security there shall be placed on the first or second page of every prospectus the following statement in capital letters:

TO FACILITATE THE OFFERING, IT IS INTENDED TO STABILIZE THE PRICE(S) OF _____
(Identify security(ies) in _____
which stabilizing transactions will be effected)
ON _____
(Identify exchange(s) on which stabilizing transactions will be effected. If none, omit this line)

THIS STATEMENT IS NOT AN ASSURANCE THAT THE PRICE(S) OF THE ABOVE SECURITY(IES) WILL BE STABILIZED OR THAT THE STABILIZING, IF COMMENCED, MAY NOT BE DISCONTINUED AT ANY TIME. (C. 38, sec. 10, 48 Stat. 81; c. 404, sec. 205, 48 Stat. 906; 15 U. S. C. 77j: c. 38, sec. 19, 48 Stat. 85; c. 404, sec. 209, 48 Stat. 908; 15 U. S. C. 77s) [Gen. Rules and Regs., Rule S-827, effective March 15, 1939]

2. The Instruction Book for Form A-2 [Sec. 6.A-2] is amended by inserting immediately following paragraph 6 under the caption Instructions as to Newspaper Prospectuses, the following new paragraph:

6A. In any case in which the registrant or any of the underwriters knows or has reasonable grounds to believe that it is intended to stabilize the price of any security to facilitate the offering of the registered security there shall be placed in the newspaper prospectus the following statement in capital letters:

TO FACILITATE THE OFFERING, IT IS INTENDED TO STABILIZE THE PRICE(S) OF _____
(Identify security(ies) in _____
which stabilizing transactions will be effected)
ON _____
(Identify exchange(s) on which stabilizing transactions will be effected. If none, omit this line)

THIS STATEMENT IS NOT AN ASSURANCE THAT THE PRICE(S) OF THE ABOVE SECURITY(IES) WILL BE STABILIZED OR THAT THE STABILIZING, IF COMMENCED, MAY NOT BE DISCONTINUED AT ANY TIME.

Adoption of Rule X-17A-2 and of Forms X-17A-1, 2 and 3.

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, as amended, particularly Sections 17 (a) and 23 (a) thereof, hereby takes the following action:

1. The following new rule is adopted:

SEC. 10.X-17A-2 (Rule X-17A-2). *Reports of Certain Stabilizing Activities.*—(a) Every member of a national securities exchange, and every broker or dealer who transacts a business in securities through the medium of any such member, and every broker or dealer registered pursuant to section 15 [C. 404, sec. 15, 48 Stat. 895; c. 462, sec. 3, 49 Stat. 1377; c. 677, sec. 1, 52 Stat. 1070; 15 U. S. C., 78o and Sup. III; 15 U. S. C. 78o-3] of the Securities Exchange Act of 1934, as amended, who effects any transactions for the purpose of pegging, fixing or stabilizing (hereinafter referred to as stabilizing) the price of any security to facilitate an offering in respect of which a registration statement is filed under the Securities Act of 1933, as amended, shall send to the Commission in triplicate—

(1) a report on Form X-17A-1 [Sec. 11.X-17A-2] on the first business day following each day on which any purchase or sale of the offered security or the security being stabilized is effected by the manager of the stabilizing syndicate, as such, or if there is no such syndicate, by such member, broker or dealer, for his own account;

(2) a report on Form X-17A-2 [Sec. 11.X-17a-2] on the first business day following each day on which such member, broker or dealer effects, for any account, any purchase or sale of the offered security or the security being stabilized which is not otherwise reported on Form X-17A-1 [Sec. 11.X-17A-1];

(3) reports on Form X-17A-1 [Sec. 11.X-17A-1] within three business days following the date on which the stabilizing is commenced, covering each day in the twenty days preceding such date on which such member, broker or dealer effected, for his own account, any purchase or sale of the offered security of the security being stabilized; and

(4) a report on Form X-17A-3 [Sec. 11.X-17A-3] within ten days following the first day on which each offering, which the stabilizing transactions are designed to facilitate, is made.

(b) Promptly upon the termination of the stabilizing, notice of such termination shall be given to the Commission. The reports required by clauses (1) and (2) of paragraph (a) shall be filed until the stabilizing is terminated and the Commission is so notified, except that if any stabilizer then has a short position in any such security, he shall send to the Commission a report on Form X-17A-1 [Sec. 11.X-17A-1] on the first business day following each day on which the manager of the stabilizing syndicate, as such, effects any purchase to cover such short position, and a report on Form X-17A-2 [Sec. 11.X-17A-2] on the first business day following each day on which such stabilizer effects a purchase, otherwise than through such manager, to cover such short position. Separate reports shall be filed as to each such security and may be filed by one or more of the stabilizers on behalf of any of the stabilizers. For the purpose of this rule and the forms prescribed hereby, the term "offered security" includes any security of the same class. Reports filed pursuant to this rule will be available for public inspection after the stabilizers have filed all the reports required hereby. (C. 404, sec. 17, 48 Stat. 897; c. 462, sec. 4, 49 Stat. 1379; 15 U. S. C., 78q and Sup. III. c. 404, sec. 23, 48 Stat. 901; c. 462, sec. 8, 49 Stat. 1379; 15 U. S. C. 78w and Sup. III) [Gen. Rules and Regs., Rule X-17A-2, effective March 15, 1939].

2. Forms X-17A-1 [Sec. 11.X-17A-1], X-17A-2 [Sec. 11.X-17A-2], and X-17A-3 [Sec. 11.X-17A-3] are hereby adopted. (c. 404, sec. 17, 48 Stat. 897; c. 462, sec. 4, 49 Stat. 1379; 15 U. S. C., 78q and Sup. III) [Forms X-17A-1, X-17A-2 and X-17A-3, effective March 15, 1939].

The foregoing rules, amendment and forms shall be effective on March 15, 1939, but shall not apply in any case in which the registration statement under the Securities Act of 1933, as amended, becomes effective before such date.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 39-491; Filed, February 10, 1939; 11:14 a. m.]

TITLE 26—INTERNAL REVENUE

BUREAU OF INTERNAL REVENUE

[Regulations 101]

INCOME TAX UNDER THE REVENUE ACT OF 1938

[*The Table of Contents and Chapters I–IX appeared in the Federal Register for Friday, February 10, 1939.*]

CHAPTER X

Corporations Exempt From Tax

Subtitle C—Supplemental Provisions, Supplement A—Rates of Tax (Supplementary to Subtitle B, Part I)

SEC. 101. *Exemptions from tax on corporations.*—The following organizations shall be exempt from taxation under this title—

ART. 101–1. *Proof of exemption.*—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. Although religious or apostolic associations or corporations exempt under section 101 (18) are relieved from paying the tax, they are required to file returns of income (see article 101 (18)–1).

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of, the affidavit referred to above:

(1) Fraternal beneficiary societies, orders, or associations: (*a*) The number of subordinate lodges in active operation, (*b*) whether periodical meetings are actually held;

(2) Building and loan associations and cooperative banks: These associations and banks shall submit the information required by Questionnaire, Form 1027, copies of which may be obtained from any collector;

(3) Corporations, community chests, funds, or foundations claiming exemption under section 101 (6): To what extent the activities of the organization involve carrying on propaganda, or otherwise attempting, to influence legislation;

(4) Educational organizations: In addition to the information called for in (3) above, whether any of the shareholders are paid by the organization, and if so, the reason for each such payment and the amount thereof;

(5) Hospitals: In addition to the information called for in (3) above, whether part-pay or non-pay patients are accepted and whether the amounts paid by part-pay patients are more than nominal;

(6) Business leagues: (*a*) A statement of the services performed for members, (*b*) a statement of the services performed for nonmembers;

(7) Clubs: The income received from the use of the facilities by the general public;

(8) Benevolent life insurance associations: (*a*) The number of counties in which the association accepts risks, (*b*) copies of the policies or certificates of membership;

(9) Mutual insurance companies: (*a*) Copies of the policies or certificates of membership; (*b*) if any substantial amount of income is claimed to be held for the payment of losses or expenses, a statement based upon a reliable table of loss experience demonstrating that the amount so held for the payment of losses is reasonably necessary; or in the case of expenses, a statement based upon reliable statistics showing that the expenses were incurred or that in all probability they will be incurred;

(10) Farmers' cooperative associations: These associations shall submit the information required by Questionnaire, Form 1028, copies of which may be obtained from any collector;

(11) Holding companies: (*a*) The name of the organization for which it holds title, (*b*) the information necessary to establish the exemption, under section 101, of the organization for which title is held.

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. But see article 101 (18)–1 with respect to religious or apostolic associations or corporations. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

The exemption under section 101 referred to in this article and articles 101 (2)–1 to 101 (13)–1 from filing returns of income does not apply to returns of information (see sections 147 to 149).

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(1) Labor, agricultural, or horticultural organizations;

ART. 101 (1)–1. *Labor, agricultural, and horticultural organizations.*—The organizations contemplated by section 101 (1) as entitled to exemption from income taxation are those which—

(1) Have no net income inuring to the benefit of any member;

(2) Are educational or instructive in character; and

(3) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Organizations such as county fairs and like associations of a quasi public character, which are designed to encourage the development of better agricultural and horticultural products through a system of awards, and whose income from gate receipts, entry fees, and donations is used exclusively to meet the necessary expenses of upkeep and operation, are thus exempt. On the other hand, associations which have for their purpose, for example, the holding of periodical race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(2) Mutual savings banks not having a capital stock represented by shares;

ART. 101 (2)–1. *Mutual savings banks.*—In order that a corporation may be entitled to exemption as a mutual savings bank, it must appear that it is an organization—

(1) Which has no capital stock represented by shares, and

(2) Whose earnings, less only the expenses of operation, are distributable wholly among the depositors.

If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt.

A mutual savings bank need not be incorporated or be under public supervision, unless, in either case a State statute so requires, nor need it serve the public in general, in order to be exempt. It may confine its business to a designated class of individuals, such as employees of a single corporation, without losing its exempt status.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(3) Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

ART. 101 (3)-1. *Fraternal beneficiary society.*—A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

ART. 101 (4)-1. *Building and loan associations and cooperative banks.*—A building and loan association organized pursuant to and operating in accordance with the laws of the United States or a State or Territory thereof, substantially all the business of which association is confined to making loans to members, is entitled to exemption.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

ART. 101 (5)-1. *Cemetery companies.*—A cemetery company may be entitled to exemption—

(1) If it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for purpose of resale, or

(2) If it is not operated for profit.

Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of the Act may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation, or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, provided that its articles of incorporation require—

(1) That the preferred stock shall be retired at par as soon as sufficient funds available therefor are realized from sales, and

(2) That all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the company for the care and improvement of the cemetery property.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

ART. 101(6)-1. *Religious, charitable, scientific, literary, and educational organizations and community chests.*—In order to be exempt under section 101 (6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Act is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an association of either class has incidental amusement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Act. However, the publication of books or the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting, to influence legislation form no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial, and educational nature.

Since a corporation to be exempt under section 101 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt under section 101 (6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. See section 101 (18) as to religious or apostolic associations or corporations.

A corporation otherwise exempt under section 101 (6) does not lose its status as an exempt corporation by receiving income such as rent, dividends and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

Money contributed by members of an organization to a common fund to be applied to the relief of the particular members of the organization or their families when in sickness, unemployed, in want, or under other disability, is not a charitable fund.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;

ART. 101 (7)-1. *Business leagues, chambers of commerce, real estate boards, and boards of trade.*—A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to

prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of the law and is not exempt from tax.

[SEC. 101. *Exemptions from tax on corporations.*]

[*The following organizations shall be exempt from taxation under this title*—]

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;

ART. 101. (8)–1. *Civic leagues and local associations of employees.*—Civic leagues entitled to exemption under section 101 (8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101 (6). Certain local associations of employees are also expressly entitled to exemption under section 101 (8). The Act prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. See article 101 (6)–1 with reference to the meaning of "charitable" and "educational" and article 101 (10)–1 as to the meaning of "local" as used in the Act.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

ART. 101 (9)–1. *Social clubs.*—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

ART. 101 (10)–1. *Local benevolent life insurance associations, mutual irrigation and telephone companies, and like organizations.*—It is a prerequisite to exemption under section 101 (10) that at least 85 percent of the income of the organization shall consist of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 101 (10). It applies, however, to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State it cannot be considered to be purely local in character.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;

ART. 101 (11)–1. *Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations.*—To be exempt under section 101 (11) the business of the organization must be purely mutual and its income must be used or held solely for the purpose of paying losses or expenses. Neither the extent of the territory in which the company may properly operate nor the fact that it accepts premium deposits instead of assessments is decisive as to its exemption. The writing of nonmutual insurance regardless of amount will deprive a company of the exemption.

The term "casualty" as used in section 101 (11) is limited to those forms of indemnity insurance providing for payment of loss or damage to property or personal injury to third persons resulting from accident or some such unanticipated contingency other than fire or the elements, and does not include indemnity from loss through accident resulting in bodily injury to, or death of, the insured.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph;

ART. 101 (12)–1. *Farmers' cooperative marketing and purchasing associations.*—(*a*) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, live-stock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax and shall not be required to file returns. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Act and is not exempt. In other words, nonmember patrons must be treated the same as members in so far as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale,

less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirement of the Act that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of the products furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers. The Act does not require, however, that the association keep ledger accounts with each producer selling through the association. Any permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers will suffice. While under the Act patronage dividends must be paid to all producers on the same basis, this requirement is complied with if an association, instead of paying patronage dividends to nonmember producers in cash, keeps permanent records from which the proportionate shares of the patronage dividends due to nonmember producers can be determined, and such shares are made applicable toward the purchase price of a share of stock or of a membership in the association.

An association which has capital stock will not for such reason be denied exemption, (1) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (2) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to such actual producers. If by statutory requirement all officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional restriction or prohibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends. The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installment of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farmers' cooperative marketing association, and is entitled to participate in the management of the association, must be regarded as a member of such association within the meaning of section 101 (12).

(*b*) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The term "supplies and equipment" as used in section 101 (12) includes groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household. The provisions of (*a*) relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 percent of the value of all its purchases.

(*c*) In order to be exempt under either (*a*) or (*b*) an association must establish that it has no net income for its own account other than that reflected in a reserve or surplus authorized in (*a*). An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Act. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under section 101 (12) and this article. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 101 (12).

(*d*) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like, such as marketing building materials, are not exempt.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose;

ART. 101 (13)–1. *Corporations organized to finance crop operations.*—Corporations organized by farmers' cooperative marketing or purchasing associations, or the members thereof, for the purpose of financing the ordinary crop operations of such members or other producers are also exempt, provided the marketing or purchasing association is exempt under section 101 (12), and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of article 101 (12)–1 relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this article.

[SEC. 101. *Exemptions from tax on corporations.*]

[The following organizations shall be exempt from taxation under this title—]

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(15) Corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes;

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments upon the teaching salaries of members, and income in respect of investments;

(18) Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or

corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-rata shares, whether distributed or not, of the net income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

ART. 101 (18)–1. *Religious or apostolic associations or corporations.*—Religious or apostolic associations or corporations are exempt from taxation under Title I if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members includes (at the time of filing his return) in his gross income his entire pro rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

Every association or corporation claiming exemption as a religious or apostolic association or corporation under the provisions of section 101 (18) and this article shall make for each taxable year a return stating specifically the items of its gross income and deductions, and its net income, and there shall be attached to the return as a part thereof a statement showing the name and address of each member of the association or corporation and the amount of his distributive share of the net income of the association or corporation for such year. If the taxable year of any member is different from the taxable year of the association or corporation, the distributive share of the net income of the association or corporation to be included in the gross income of the member for his taxable year shall be based upon the net income of the association or corporation for the taxable year of the association or corporation ending within the taxable year of the member.

CHAPTER XI

Corporations Used to Avoid Surtax

SEC. 102. *Surtax on corporations improperly accumulating surplus.*—(a) *Imposition of tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this title) upon the net income of every corporation (other than a personal holding company as defined in Title IA or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

25 per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

35 per centum of the undistributed section 102 net income in excess of $100,000.

(b) *Prima facie evidence.*—The fact that any corporation is a mere holding or investment company shall be prima facie evidence of a purpose to avoid surtax upon shareholders.

(c) *Evidence determinative of purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

(d) *Definitions.*—As used in this title—

(1) *Section 102 net income.*—The term "section 102 net income" means the net income minus the sum of—

(A) *Taxes.*—Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

(B) *Disallowed charitable, etc., contributions.*—Contributions or gifts payment of which is made within the taxable year, not otherwise allowed as a deduction, to or for the use of donees described in section 23 (o), for the purposes therein specified.

(C) *Disallowed losses.*—Losses from sales or exchanges of capital assets which are disallowed as a deduction by section 117 (d).

(2) *Undistributed section 102 net income.*—The term "undistributed section 102 net income" means the section 102 net income minus the basic surtax credit provided in section 27 (b), but the computation of such credit under section 27 (b) (1) shall be made without its reduction by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(e) *Tax on personal holding companies.*—For surtax on personal holding companies, see Title IA.

ART. 102–1. *Taxation of corporation formed or utilized for avoidance of surtax.*—Section 102 imposes (in addition to other taxes imposed by Title I) a graduated income tax or surtax upon any domestic or foreign corporation formed or availed of to avoid the imposition of the individual surtax upon its shareholders or the shareholders of any other corporation through the medium of permitting earnings or profits to accumulate instead of dividing or distributing them. However, personal holding companies, as defined in Title IA, and foreign personal holding companies, as defined in Supplement P, are excepted from taxation under section 102. The surtax imposed by section 102 applies whether the avoidance was accomplished through the formation or use of only one corporation or a chain of corporations. For example, if the capital stock of the M Corporation is held by the N Corporation so that the dividend distributions of the M Corporation would not be returned as income subject to the individual surtax until distributed in turn by the N Corporation to its individual shareholders, nevertheless the surtax imposed by section 102 applies to the M Corporation, if that corporation is formed or availed of for the purpose of preventing the imposition of the individual surtax upon the individual shareholders of the N Corporation.

A foreign corporation, whether resident or nonresident, formed or availed of for the purpose specified in section 102 is subject to the tax imposed thereby if it derives income from sources within the United States as defined in section 119 and the regulations thereunder, if any of its shareholders are (1) citizens or residents of the United States and therefore subject to the surtax with respect to distributions of the corporation or (2) nonresident alien individuals who, by the application of section 211 (b) or section 211 (c), would be subject to the surtax with respect to distributions of the corporation which if made would constitute income from sources within the United States (see section 119) or (3) foreign corporations if any beneficial interest therein is owned directly or indirectly by any shareholder specified in (1) or (2). On the other hand, the tax imposed by section 102 will not apply even though a foreign corporation, whether resident or nonresident, derives income from sources within the United States, if all of its shareholders are nonresident alien individuals who, by the application of section 211 (a) as amended, would not be subject to surtax with respect to distributions of the corporation if made.

For the computation of the surtax see article 102–4.

ART. 102–2. *Purpose to avoid surtax; evidence; burden of proof; definition of holding or investment company.*—The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding the individual surtax is subject to disproof by competent evidence. The existence or nonexistence of the purpose may be indicated by circumstances other than the evidence specified in the Act, and whether or not such purpose was present depends upon the particular circumstances of each case. In other words, a corporation is subject to taxation under section 102 if it is formed or availed of for the *purpose* of preventing the imposition of surtax upon shareholders through the medium of permitting earnings or profits to accumulate, even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits; and on the other hand, the fact that a corporation is such a company or has such an accumulation is not absolutely conclusive against it if, by clear and convincing evidence, the taxpayer satisfies the Commissioner that the corporation was neither formed or availed of for the purpose of avoiding the individual surtax. All the other circumstances which might be construed as evidence of the purpose to avoid surtax cannot be outlined, but among other things the following will be considered: (1) Dealings

between the corporation and its shareholders, such as withdrawals by the shareholders as personal loans or the expenditure of funds by the corporation for the personal benefit of the shareholders, and (2) the investment by the corporation of undistributed earnings in assets having no reasonable connection with the business. The mere fact that the corporation distributed a large portion of its earnings for the year in question does not necessarily prove that earnings were not permitted to accumulate beyond reasonable needs or that the corporation was not formed or availed of to avoid surtax upon shareholders.

If the Commissioner determines that the corporation was formed or availed of for the purpose of avoiding the individual surtax through the medium of permitting earnings or profits to accumulate, and the taxpayer contests such determination of fact by litigation, the burden of proving the determination wrong by a preponderance of evidence, together with the corresponding burden of first going forward with evidence, is on the taxpayer under principles applicable to income tax cases generally, and this is so even though the corporation is not a mere holding or investment company and does not have an unreasonable accumulation of earnings or profits. However, if the corporation *is* a mere holding or investment company, then the Avt gives further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid surtax upon shareholders, while if earnings or profits are permitted to accumulate beyond the reasonable needs of the business, then the Act adds still more weight to the Commissioner's determination by providing that irrespective of whether or not the corporation is a mere holding or investment company, the existence of such an accumulation is *determinative* of the purpose to avoid surtax upon shareholders unless the taxpayer proves the contrary by such a clear preponderance of all the evidence that the absence of such a purpose is unmistakable.

A corporation having practically no activities except holding property, and collecting the income therefrom or investing therein, shall be considered a holding company within the meaning of section 102. If the activities further include, or consist substantially of, buying and selling stocks, securities, real estate, or other investment property (whether upon an outright or a marginal basis) so that the income is derived not only from the investment yield but also from profits upon market fluctuations, the corporation shall be considered an investment company within the meaning of section 102.

ART. 102-3. *Unreasonable accumulations of profits.*—An accumulation of earnings or profits (including the undistributed earnings or profits of prior years) is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent accumulations of surplus for the reasonable needs of the business if the purpose is not to prevent the imposition of the surtax. No attempt is here made to enumerate all the ways in which earnings or profits of a corporation may be accumulated for the reasonable needs of the business. Undistributed income is properly accumulated if retained for working capital needed by the business; or if invested in additions to plant reasonably required by the business; or if in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. The nature of the investment of earnings or profits is immaterial if they are not in fact needed in the business. Among other things, the nature of the business, the financial condition of the corporation at the close of the taxable year, and the use of the undistributed earnings or profits will be considered in determining the reasonableness of the accumulations.

The business of a corporation is not merely that which it has previously carried on, but includes in general any line of business which it may undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to avoid the surtax. If one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance although not in legal form the business of the first corporation. Earnings or profits of the first corporation put into the second through the purchase of stock or otherwise may, therefore, if a subsidiary relationship is established, constitute employment of the income of its own business. Investment by a corporation of its income in stock and securities of another corporation is not of itself to be regarded as employment of the income in its business. The business of one corporation may not be regarded as including the business of another unless the other corporation is a mere instrumentality of the first; to establish this it is ordinarily essential that the first corporation own all or substantially all of the stock of the second.

The Commissioner, or any collector upon direction from the Commissioner, may require any corporation to furnish a statement of its accumulated earnings and profits, the name and address of, and number of shares held by each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed. (See section 148 (c).)

ART. 102-4. *Computation of undistributed section 102 net income.*—In ascertaining the tax basis for corporations subject to the provisions of section 102, the "section 102 net income" is first computed. This is accomplished in the case of a domestic corporation by subtracting from the corporate net income, as defined in sections 21 and 204, (*a*) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23 (c), but not including the graduated income tax or surtax imposed by section 102 or corresponding sections of prior Revenue Acts; (*b*) contributions or gifts payment of which is made within the taxable year, not otherwise allowed as a deduction, to or for the use of donees described in section 23 (o), for the purposes therein specified; (*c*) losses from sales or exchanges of capital assets which are disallowed as a deduction by section 117 (d). In the case of a foreign corporation, whether resident or nonresident, which files or causes to be filed a return the "section 102 net income" means the net income from sources within the United States (gross income from sources within the United States, as defined in section 119 and the regulations thereunder, less statutory deductions) minus the amount of the deductions enumerated in (*a*), (*b*), and (*c*) above. In the case of a foreign corporation, whether resident or nonresident, which files no return the "section 102 net income" means the gross income from sources within the United States, as defined in section 119, and the regulations thereunder, without the benefit of the deductions enumerated in (*a*), (*b*), and (*c*) above, or any other deductions. (See section 233.)

The "section 102 net income" includes interest upon obligations of the United States and obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States, except as provided in section 22 (b) (4). The "section 102 net income" does not include interest on obligations of States or Territories of the United States or any political subdivision thereof or of the District of Columbia or of the possessions of the United States.

The "undistributed section 102 net income" is computed by subtracting from the "section 102 net income" described above, the amount of the basic surtax credit provided in section 27 (b). In computing the basic surtax credit for the purpose of section 102, the credit under section 27 (b) (1) is not to be reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

CHAPTER XII

Tax on Citizens and Corporations of Foreign Countries—Banks and Trust Companies—Sale of Oil or Gas Properties

SEC. 103. *Rates of tax on citizens and corporations of certain foreign countries.*—Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial

taxes, the President shall so proclaim and the rates of tax imposed by sections 11, 12, 13, 14, 201 (b), 204 (a), 207, 211 (a), 231 (a), and 362 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by section 11, 12, 13, 14, 201 (b), 204 (a), 207, 211 (a), 231 (a), or 362, as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 per centum of the net income of the taxpayer. Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

SEC. 104. *Banks and trust companies.*—(a) *Definition.*—As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, as amended, and which is subject by law to supervision and examination by State, Territorial, or Federal authority having supervision over banking institutions.

(b) *Rate of tax.*—Banks shall be taxable under section 14 (d).

SEC. 105. *Sale of oil or gas properties.*—In the case of a bona fide sale of any oil or gas property, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration or discovery work done by the taxpayer, the portion of the tax imposed by section 12 attributable to such sale shall not exceed 30 per centum of the selling price of such property or interest.

ART. 105–1. *Surtax on sale of oil or gas properties.*—If the taxpayer by prospecting and locating claims, or by exploring or discovering undeveloped claims, has demonstrated the principal value of oil or gas property, which prior to his efforts had a relatively minor value, the portion of the surtax imposed by section 12 attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 30 percent of the selling price. Shares of stock in a corporation owning oil or gas property do not constitute an interest in such property. To determine the application of section 105 to a particular case, the taxpayer should first compute the surtax imposed by section 12 upon his entire surtax net income, including the net income from any sale of such property or interest therein, without regard to section 105. The proportion of the surtax, so computed, indicated by the ratio which the taxpayer's net income from the sale of the property or interest therein, computed as prescribed in this article, bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 30 percent of the selling price of such property or interest, such portion of the surtax shall be reduced to that amount.

In determining the portion of the net income attributable to the sale of such oil or gas property or interest therein, the taxpayer shall allocate to the gross income derived from such sale, and to the gross income derived from all other sources, the expenses, losses, and other deductions properly appertaining thereto and shall apply any general expenses, losses, and deductions (which cannot properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from the sale of such oil or gas property or interest therein, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income attributable to such sale. The taxpayer shall submit with his return a statement fully explaining the manner in which such expenses, losses, and deductions are allocated or apportioned.

SEC. 106. *Claims against United States involving acquisition of property.*—In the case of amounts (other than interest) received by a taxpayer from the United States with respect to a claim against the United States involving the acquisition of property and remaining unpaid for more than fifteen years, the portion of the tax imposed by section 12 attributable to such receipt shall not exceed 30 per centum of the amount (other than interest) so received.

ART. 106–1. *Surtax on certain amounts received from the United States.*—The method of computation provided for in article 105–1, relating to the limitation on surtax on the sale of oil or gas properties, shall be applicable in computing, under section 106, the surtax imposed by section 12 attributable to certain amounts received by the taxpayer from the United States under a claim involving acquisition of his property. The surtax limitation provided in section 106 is not applicable to any amount received from the United States which constitutes interest, whether such interest was included in the claim or in any judgment thereon or has accrued on such judgment.

CHAPTER XIII

Gain or Loss—Recognition, Basis, Determination

Supplement B—Computation of Net Income [Supplementary to Subtitle B, Part II]

SEC. 111. *Determination of amount of, and recognition of, gain or loss.*—(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(d) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

ART. 111–1. *Computation of gain or loss.*—Except as otherwise provided, the Act regards as income or as loss sustained, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 111, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 113 (b) and articles 113 (b)–1 to 113 (b)–3 (i. e., the cost or other basis provided by section 113 (a), adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained in the amount of the insufficiency. The basis may be different depending upon whether gain or loss is being computed.

Even though property is not sold or otherwise disposed of, gain (includible in gross income under section 22 (a) as "gains or profits and income derived from any source whatever") is realized if the sum of all the amounts received which are required by section 113 (b) to be applied against the basis of the property exceeds such basis. On the other hand, a loss is not ordinarily sustained prior to the sale or other disposition of the property, for the reason that until such sale or other disposition occurs there remains the possibility that the taxpayer may recover or recoup the adjusted basis of the property. Until some identifiable event fixes the actual sustaining of a loss and the amount thereof the Act takes no account of it. The provisions of this paragraph may be illustrated by the following example:

Example: A purchased certain shares of stock subsequent to February 28, 1913, for $10,000. On January 1, 1938, A's adjusted basis for the stock had been reduced to $1,000, by reason of receipts and distributions described in section 113 (b) (1) (A) and (D). He received

in 1938 a further distribution of $5,000, being a distribution described in section 113 (b) (1) (D). This distribution applied against the adjusted basis as required by section 113 (b) (1) (D) exceeds that basis by $4,000. The amount of the excess, namely, $4,000, is a gain realized by A in 1938 includible, as a gain from the stock, in gross income in his return for that calendar year. In computing gain from the stock, as in adjusting basis, no distinction is made between items of receipts or distributions described in section 113 (b). If A sells the stock in 1939 for $5,000, he realizes in 1939 a gain of $5,000, since the adjusted basis of the stock for the purpose of computing gain or loss from the sale is zero.

In the case of property sold on the installment plan, special rules for the taxation of the gain are prescribed in section 44.

SEC. 112. *Recognition of gain or loss.*—(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

ART. 112 (a)-1. *Sales or exchanges.*—The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is to be recognized is governed by the provisions of section 112. The general rule is that the entire amount of such gain or loss is to be recognized.

An exception to the general rule is made by section 112 (b) (1) to (5), inclusive, in the case of certain specifically described exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Act provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

The Act makes specific provision for the case in which, in addition to property which may be received tax free on the exchange, there is received as boot other property or money. In such a case gain is recognized to the extent of the boot (see section 112 (c) and (d)), but no loss of any kind is recognized (see section 112 (e)).

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Act only if the exchange is one which satisfies both (1) the specific description in the Act of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

To constitute an exchange within the meaning of section 112 (b) (1) to (5), inclusive, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

See section 112 (b) (6) and (7) with respect to nonrecognition of gain or loss upon the receipt of property distributed in complete liquidation of a corporation under certain specifically described circumstances. See sections 112 (b) (8) and 371 with respect to nonrecognition of gain or loss upon exchanges and distributions made in obedience to orders of the Securities and Exchange Commission.

[SEC. 112. *Recognition of gain or loss.*]
(b) *Exchanges solely in kind.*—(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

ART. 112 (b) (1)-1. *Property held for productive use in trade or business or for investment.*—As used in section 112 (b) (1), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

No gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose, or (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unimproved real estate, or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

Gain or loss is recognized if a taxpayer exchanges (1) Treasury bonds maturing October 15, 1945, for Treasury bonds maturing June 15, 1963, or (2) a real estate mortgage for bonds of the Home Owners' Loan Corporation.

[SEC. 112. *Recognition of gain or loss.*]
[(b) *Exchanges solely in kind.*—]
(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

ART. 112 (b) (2)-1. *Stock for stock of the same corporation.*—The exchange, without the recognition of gain or loss, of common stock for common stock, or of preferred stock for preferred stock, in the same corporation is not limited to a transaction between a stockholder and the corporation; it includes an exchange between two individual stockholders. However, the provisions of section 112 (b) (2) do not apply if stock is exchanged for bonds, or preferred stock is exchanged for common stock, or common stock is exchanged for preferred stock, or common stock in one corporation is exchanged for common stock in another corporation.

[SEC. 112. *Recognition of gain or loss.*]
[(b) *Exchanges solely in kind.*—]
(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

ART. 112 (b) (5)-1. *Transfer of property to corporation controlled by transferor.*—As used in section 112 (b) (5), the phrase "one or more persons" includes individuals, trusts or estates, partnerships and corporations (see section 901); and to be in "control" of the transferee corporation such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of

such corporation. (See section 112 (h).) The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

Example 1: A owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $150,000 in 1938. He transfers this property to the M Corporation, a newly formed company, for all the latter's capital stock. No gain or loss is recognized on the transaction.

Example 2: C owns a patent right worth $25,000 and D owns a manufacturing plant, worth $75,000. C and D organize the R Corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example 3: B owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $200,000 in 1938. He transfers the property to the N Corporation in 1938 for 78 percent of each class of stock of the corporation, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1933 to other persons for cash. B realizes a taxable gain of $150,000 on this transaction. (See section 112 (h).)

ART. 112 (b) (5)–2. *Records to be kept and information to be filed.*—Every person who receives the stock or securities of a controlled corporation for property under section 112 (b) (5) shall file with his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including—

1. A description of the property transferred, or of his interest in such property, together with a statement of the cost or other basis thereof, adjusted to the date of the transfer, and

2. A statement of the amount of stock or securities and other property or money received in the exchange. The amount of each kind of stock or securities and other property received shall be set forth at its fair market value at the date of the exchange.

Every such controlled corporation shall file with its income tax return for the taxable year in which the exchange takes place:

(1) A full description of all property received from the transferors, together with a statement of the cost or other basis thereof in the hands of the transferors adjusted to the date of the transfer, and

(2) A statement of the amount of stock or securities and other property or money which passed to the transferors in the transaction, together with a full statement of the amount of the issued and outstanding stock and securities of such controlled corporation immediately after the exchange and of the ownership of each transferor of each class of stock of such controlled corporation immediately after the exchange (showing as to each class the number of shares and percentage owned and the voting power of each share).

Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange under section 112 (b) (5) showing the cost or other basis in his hands of the transferred property, and of the amount of stock or securities and other property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received in the exchange.

[SEC. 112. *Recognition of gain or loss.*]

[(*b*) *Exchanges solely in kind.*—]

(6) *Property received by corporation on complete liquidation of another.*—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

ART. 112 (b) (6)–1. *Distributions in liquidation of subsidiary corporation.*—(*a*) *General.*—Under the general rule prescribed by section 115 (c) for the treatment of distributions in liquidation of a corporation, amounts received by one corporation in complete liquidation of another corporation are treated as in full payment in exchange for stock in such other corporation, and gain or loss from the receipt of such amounts is to be determined as provided in section 111. The scope of this treatment is governed by the meaning of the term "amounts distributed in complete liquidation of a corporation" as used in section 115 (c). Section 112 (b) (6) excepts from the general rule property received, under certain specifically described circumstances, by one corporation as a distribution in complete liquidation of another corporation and provides for the nonrecognition of gain or loss in those cases which meet the statutory requirements. Section 112 (i) places a limitation on the application of section 112 (b) (6) in the case of foreign corporations. See article 113 (a) (15)–1 for the basis for determining gain or loss from the subsequent sale of property received upon complete liquidations such as described in this article.

(*b*) *Requirements for nonrecognition of gain or loss.*—The nonrecognition of gain or loss is limited to the receipt of such property by a corporation which is the actual owner of stock (in the liquidating corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends). The Act expressly requires that the recipient corporation must have

been the owner of the specified amount of such stock on the date of the adoption of the plan of liquidation and have continued so to be at all times until the receipt of the property. The Act also expressly requires that the recipient corporation shall at no time on or after the date of the adoption of the plan and until the receipt of the property, be the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property. If the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation and if the failure to continue qualified occurs at any time prior to the completion of the transfer of all the property, the provisions for the nonrecognition of gain or loss do not apply to any distribution received under the plan.

The provisions of section 112 (b) (6) do not apply to any liquidation if any distribution in pursuance thereof has been made before the first day of the first taxable year of the recipient corporation beginning after December 31, 1935.

To constitute a distribution in complete liquidation within the meaning of section 112 (b) (6), the distribution must be (*a*) made by the liquidating corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation or (*b*) one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation. It is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue to the date of dissolution of the corporation. A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts and distributing any remaining balance to its shareholders. A liquidation may be completed prior to the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible). (See article 22 (a)-21.)

If a transaction constitutes a distribution in complete liquidation within the meaning of the Act and satisfies the requirements of section 112 (b) (6), it is not material that it is otherwise described under the local law. If a liquidating corporation distributes all of its property in complete liquidation and if pursuant to the plan for such complete liquidation a corporation owning the specified amount of stock in the liquidating corporation receives property constituting amounts distributed in complete liquidation within the meaning of the Act and also receives other property attributable to shares not owned by it, the transfer of the property to the recipient corporation shall not be treated, by reason of the receipt of such other property, as not being a distribution (or one of a series of distributions) in complete cancellation or redemption of all of the stock of the liquidating corporation within the meaning of section 112 (b) (6), even though for purposes of those provisions in section 112 relating to reorganizations the amount received by the recipient corporation in excess of its ratable share is regarded as acquired upon the issuance of its stock or securities in a tax-free exchange as described in section 112 (b) (4) and the cancellation or redemption of the stock not owned by the recipient corporation is treated as occurring as a result of a tax-free exchange described in section 112 (b) (3). The application of this paragraph may be illustrated by the following example:

Example: On July 1, 1938, the M Corporation had outstanding capital stock consisting of 3,000 shares of common stock, par value $100 a share, and 1,000 shares of preferred stock, par value $100 a share, which preferred stock was limited and preferred as to dividends and had no voting rights. On July 1, 1938, and thereafter until the date of dissolution of the M Corporation, the O Corporation owned 2,500 shares of the common stock of the M Corporation. By a statutory merger consummated on August 1, 1938, pursuant to a plan of liquidation adopted on July 1, 1938, the M Corporation was merged into the O Corporation, the O Corporation under the plan issuing stock which was received by the holders of the stock of the M Corporation not owned by the O Corporation in exchange for their stock in the M Corporation. The receipt by the O Corporation of the properties of the M Corporation is a distribution received by the O Corporation in complete liquidation of the M Corporation within the meaning of section 112 (b) (6), and no gain or loss is recognized as the result of the receipt of such properties.

ART. 112 (b) (6)-2. *Liquidations completed within one taxable year.*—If in a liquidation completed within one taxable year, pursuant to a plan of complete liquidation, distributions in complete liquidation are received by a corporation which owns the specified amount of stock in the liquidating corporation and which continues qualified with respect to the ownership of such stock until the transfer of all the property within such year is completed (see article 112 (b) (6)-1), then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no waiver or bond is required of the recipient corporation under section 112 (b) (6).

ART. 112 (b) (6)-3. *Liquidations covering more than one taxable year.*—If the plan of liquidation is consummated by a series of distributions covering a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidation shall in addition to the requirements of article 112 (b) (6)-1, be subject to the following requirements:

(*a*) In order for the distribution in liquidation to be brought within the exception provided in section 112 (b) (6) to the general rule for computing gain or loss with respect to amounts received in liquidation of a corporation, the entire property of the corporation shall be transferred in accordance with a plan of liquidation, which plan shall include a statement showing the period within which the transfer of the property of the liquidating corporation to the recipient corporation is to be completed. The transfer of all the property under the liquidation must be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan.

(*b*) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall, at the time of filing its return, file with the collector for transmittal to the Commissioner a waiver of the statute of limitations on assessment. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period for assessment of all income and profits taxes for each such year to a date not earlier than one year after the last date of the period for assessment of such taxes for the last taxable year in which the transfer of the property of the liquidating corporation to the controlling corporation may be completed in accordance with section 112 (b) (6). Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation.

(*c*) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall file a bond, the amount of which shall be fixed by the Commissioner. The bond shall contain all terms specified by the Commissioner, including provisions unequivocally assuring prompt payment of the excess of income and profits taxes (plus penalty, if any, and interest) as computed by the Commissioner without regard to the provisions of sections 112 (b) (6) and 113 (a) (15) over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 272 and regardless of whether it may or may not be assessed. Any bond required under section 112 (b) (6) shall have such surety or sureties as the Commissioner may require. However, see section 1126 of the Revenue Act of 1926, as amended (paragraph 35 of the Appendix to these regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may

be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or the depositary may each have a copy.

Pending the completion of the liquidation, if there is a compliance with paragraphs (*a*), (*b*), and (*c*) of this article and article 112 (b) (6)–1 with respect to the nonrecognition of gain or loss, the income and profits tax liability of the recipient corporation for each of the years covered in whole or in part by the liquidation shall be determined without the recognition of any gain or loss on account of the receipt of the distributions in liquidation. In such determination, the basis of the property or properties received by the recipient corporation shall be determined in accordance with section 113 (a) (15). (See article 113 (a) (15)–1.) However, if the transfer of the property is not completed within the 3-year period allowed by section 112 (b) (6) or if the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of section 112 (b) (6) or section 113 (a) (15) and the amount of any additional tax due upon such recomputation shall be promptly paid.

ART. 112 (b) (6)–4. *Distributions in liquidation as affecting minority interests.*— Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 112 (b) (6), since it does not apply to that part of distributions in liquidations received by minority shareholders.

ART. 112 (b) (6)–5. *Records to be kept and information to be filed with return.*— (*a*) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 112 (b) (6) showing the information required by this article to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(*b*) For the taxable year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan, the recipient shall file with its return a complete statement of all facts pertinent to the nonrecognition of gain or loss, including—

(1) A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to, or pursuant to, the plan.

(2) A list of all the properties received upon the distribution, showing the cost or other basis of such properties to the liquidating corporation at the date of distribution and the fair market value of such properties on the date distributed.

(3) A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

[SEC. 112. *Recognition of gain or loss.*]

[(*b*) *Exchanges solely in kind.*—]

(7) *Election as to recognition of gain in certain corporate liquidations.*—(A) *General rule.*—In the case of property distributed in complete liquidation of a domestic corporation, if—

(i) the liquidation is made in pursuance of a plan of liquidation adopted after the date of the enactment of this Act, whether the taxable year of the corporation began on, before, or after January 1, 1938; and

(ii) the distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within the month of December, 1938—

then in the case of each qualified electing shareholder (as defined in subparagraph (C)) gain upon the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subparagraph (E) and (F).

(B) *Excluded corporation.*—The term "excluded corporation" means a corporation which at any time between April 9, 1938, and the date of the adoption of the plan of liquidation, both dates inclusive, was the owner of stock possessing 50 per centum or more of the total combined voting power of all classes of stock entitled to vote on the adoption of such plan.

(C) *Qualified electing shareholders.*—The term "qualified electing shareholder" means a shareholder (other than an excluded corporation) of any class of stock (whether or not entitled to vote on the adoption of the plan of liquidation) who is a shareholder at the time of the adoption of such plan, and whose written election to have the benefits of subparagraph (A) has been made and filed in accordance with subparagraph (D), but—

(i) in the case of a shareholder other than a corporation, only if written elections have been so filed by shareholders (other than corporations) who at the time of the adoption of the plan of liquidation are owners of stock possessing at least 80 per centum of the total combined voting power (exclusive of voting power possessed by stock owned by corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation; or

(ii) in the case of a shareholder which is a corporation, only if written elections have been so filed by corporate shareholders (other than an excluded corporation) which at the time of the adoption of such plan of liquidation are owners of stock possessing at least 80 per centum of the total combined voting power (exclusive of voting power possessed by stock owned by an excluded corporation and by shareholders who are not corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation.

(D) *Making and filing of elections.*—The written elections referred to in subparagraph (C) must be made and filed in such manner as to be not in contravention of regulations prescribed by the Commissioner with the approval of the Secretary. The filing must be within thirty days after the adoption of the plan of liquidation, and may be by the liquidating corporation or by the shareholder.

(E) *Noncorporate shareholders.*—In the case of a qualified electing shareholder other than a corporation—

(i) There shall be recognized, and taxed as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, such earnings and profits to be determined as of December 31, 1938, but without diminution by reason of distributions made during the month of December, 1938; and

(ii) There shall be recognized, and taxed as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of money, or of stock or securities acquired by the corporation after April 9, 1938, exceeds his ratable share of such earnings and profits.

(F) *Corporate shareholders.*—In the case of a qualified electing shareholder which is a corporation the gain shall be recognized only to the extent of the greater of the two following—

(i) The portion of the assets received by it which consists of money, or of stock or securities acquired by the liquidating corporation after April 9, 1938; or

(ii) Its ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, such earnings and profits to be determined as of December 31, 1938, but without diminution by reason of distributions made during the month of December, 1938.

ART. 112 (b) (7)–1. *Corporate liquidations in December, 1938.*—(*a*) *General.*—Section 112 (b) (7) provides a special rule, in the case of certain specifically described complete liquidations of domestic corporations occurring within the month of December, 1938, for the treatment of gain on the shares of stock owned by qualified electing shareholders on the date of the adoption of the plan of liquidation. The effect of such section is in general to postpone the recognition of that portion of a qualified electing shareholder's gain on the liquidation which would otherwise be recognized and which is attributable to appreciation in the value of certain corporate assets unrealized by the corporation at the time such assets are distributed in complete liquidation. Only qualified electing shareholders are entitled to the benefits of section 112 (b) (7). The determination of who is a qualified electing shareholder is to be made under section 112 (b) (7) (C) and article 112 (b) (7)–2. For the basis of

property received on such liquidations, see section 113 (a) (18).

(b) *Type of liquidation.*—The liquidation must be in pursuance of a plan of liquidation adopted after May 28, 1938. Such plan may be adopted at any time after May 28, 1938, and before the first distribution under the liquidation occurs, even though the date of adoption falls in a taxable year of the liquidating corporation to which the Revenue Act of 1936 applies. The Act specifically requires that the distribution be in complete cancellation or redemption of all the stock of the corporation. The Act also requires that the transfer of all the property, both tangible and intangible, of the corporation under the liquidation occur entirely within the month of December, 1938, but if proper arrangements are made in good faith for the payment, after December 31, 1938, of unascertained or contingent liabilities and expenses, this requirement will be considered to have been complied with. The assets reserved for this purpose must be in cash and must be reasonable in amount. Though it is not necessary that the corporation dissolve in December, 1938, it is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue to the date of dissolution of the corporation. A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders.

If a transaction constitutes a distribution in complete liquidation within the meaning of the Act and satisfies the requirements of section 112 (b) (7), it is immaterial that it is otherwise described under the local law.

ART. 112 (b) (7)–2. *Qualified electing shareholder.*—No corporate shareholder may be a qualified electing shareholder if at any time between April 9, 1938, and the date of the adoption of the plan of liquidation, both dates inclusive, it is the owner of stock of the liquidating corporation possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote upon the adoption of the plan of liquidation. All other shareholders are divided into two groups for the purposes of determining whether they are qualified electing shareholders: (*a*) shareholders other than corporations, and (*b*) corporate shareholders. Any shareholder of either of such two groups (whether or not the stock he owns is entitled to vote on the adoption of the plan of liquidation) is a qualified electing shareholder if—

(1) His written election to be governed by the provisions of section 112 (b) (7) (which cannot be withdrawn or revoked) has been made and filed as prescribed in article 112 (b) (7)–3; and

(2) Like elections have been made and filed by owners of stock possessing at least 80 percent of the total combined voting power of all classes of stock owned by shareholders of the same group on the date of, and entitled to vote upon, the adoption of the plan of liquidation, whether or not the shareholders making such elections actually realize gain upon the cancellation or redemption of such stock upon the liquidation.

Example: The R Corporation has outstanding 20 shares of common stock on July 1, 1938, the date of the adoption of a plan of liquidation within the provisions of section 112 (b) (7), each entitled to one vote upon the adoption of such plan of liquidation. Ten of such shares are owned by the S Corporation, two each by the X Corporation and the Y Corporation, one by the Z Corporation, and one each by A, B, C, D, and E, individuals. There are also outstanding two shares of preferred stock, not entitled to vote on liquidation, one share being owned by F, an individual, and one share by the P Corporation. The S Corporation, being a corporate shareholder and the owner of 50 percent of the voting stock, may not be a qualified electing shareholder under any circumstances. In order for any other corporate shareholder to be a qualified electing shareholder, it is necessary that the X Corporation and the Y Corporation file their written elections to be governed by section 112 (b) (7). If this is done, the P Corporation will also be a qualified electing shareholder if it has filed a like election. Similarly, in the case of the individual shareholders, some combination of four of the individual holders of the common stock must have filed their written elections, before any individual shareholder may be considered a qualified electing shareholder, but if this is done, F will also be a qualified electing shareholder if he has filed a like election.

An election to be governed by the provisions of section 112 (b) (7) relates to the treatment of gain realized upon the cancellation or redemption of stock upon liquidation and can therefore be made only by or on behalf of the person by whom gains, if any, will be realized. Thus, the shareholder who may make such election must be the actual owner of the stock and not a mere record holder, such as a nominee.

A shareholder is entitled to make an election relative to the gain only on stock owned by him at the time of the adoption of the plan of liquidation. The election is personal to the shareholder making it and does not follow such stock into the hands of a transferee.

ART. 112 (b) (7)–3. *Making and filing of written elections.*—An election to be governed by section 112 (b) (7) shall be made in duplicate under oath or affirmation on Form 964 in accordance with the instructions printed thereon and with these regulations. Such duplicate originals shall be filed by the shareholder or by the liquidating corporation with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Records Division, within 30 days after the adoption of the plan of liquidation. A copy shall also be attached to and made a part of the shareholder's income tax return for his taxable year in which the transfer of all the property under the liquidation occurs.

ART. 112 (b) (7)–4. *Treatment of gain.*—(*a*) *Computation of gain.*—As in the case of shareholders generally, for the purpose of computing gain, amounts received by qualified electing shareholders are treated as in full payment in exchange for their stock, as provided in section 115 (c), and gain from the receipt of such amounts is determined as provided in section 111. Gain or loss must be computed separately on each share of stock owned by a qualified electing shareholder on the date of the adoption of the plan of liquidation. The limited recognition and special treatment accorded by section 112 (b) (7) applies only to the gain on such shares of stock upon which gain was realized and not to net gain computed by setting off losses realized on some shares against gain on others.

(*b*) *Recognition of gain.*—Pursuant to section 112 (b) (7) only so much of the gain on each share of stock owned by a qualified electing shareholder on the date of the adoption of the plan of liquidation is recognized as does not exceed the greater of the following—

(1) Such share's ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, computed as of December 31, 1938, without diminution by reason of distributions made during the month of December, 1938; or

(2) Such share's ratable share of the sum of the amount of money received by such shareholder on shares of the same class and the fair market value of all the stock or securities so received which were acquired by the liquidating corporation after April 9, 1938. The mere replacement after April 9, 1938, of lost or destroyed certificates or instruments acquired on or before April 9, 1938, or the mere conversion of certificates or instruments into certificates or instruments of larger or smaller denominations will not constitute an acquisition within the meaning of the phrase "acquired after April 9, 1938." Nor will such an acquisition result from the issuance after April 9, 1938, of certificates of stock in connection with a subscription made and accepted on or before April 9, 1938.

(*c*) *Treatment of recognized gain.*—In the case of a qualified electing shareholder other than a corporation that part of the recognized gain on a share of stock owned on the date of the adoption of the plan of liquidation which is not in excess of its ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, determined as provided in section

112 (b) (7) (E) (i) is treated and taxed to him as a dividend. It retains its character as a dividend for all tax purposes. The remainder of the gain which is recognized is treated and taxed to him as a short-term or long-term capital gain, as the case may be. In the case of a qualified electing shareholder which is a corporation, the entire amount of the gain which is recognized is treated and taxed as a capital gain.

Example: The X Corporation has only one class of stock outstanding, owned in equal amounts by three shareholders. The basis of the stock owned by each shareholder is $50, each having bought his stock in a single bloc prior to the date of the adoption of a plan of liquidation conforming to the requirements of section 112 (b) (7). One of such shareholders is an individual and two are corporations and all are qualified electing shareholders. The X Corporation has earnings and profits accumulated after February 28, 1913, of $60, its assets consisting of property (other than stock or securities acquired after April 9, 1938, and money) with a fair market value of $240, cash of $75, and stock and securities acquired after April 9, 1938, with a fair market value of $90, all of which assets are distributed in December, 1938, to the shareholders pro rata in complete liquidation of the corporation, as provided in section 112 (b) (7). Each shareholder, therefore, receives, in cash and property, $135 and his gain is $85.

In the case of each shareholder $55 of this gain is recognized, since such amount represents the sum of the cash received by him and the fair market value of the stock and securities received by him which were acquired by the X Corporation after April 9, 1938, and is greater than his ratable share of the earnings and profits ($20). In the case of the corporate shareholders this amount is treated as capital gain. In the case of the individual shareholder, however, $20, being the amount of the shareholder's ratable share of the earnings and profits, is taxable to him as a dividend, and $35, being the difference between the shareholder's ratable share of the earnings and profits and the sum of the cash and stock and securities received by him, is recognized and treated as a short-term or long-term capital gain, as the case may be. The remainder of each shareholder's gain, $30, is not recognized. If the basis of each shareholder's stock had been $100, instead of $50, the corporate shareholders would be taxed on only $35 as capital gain and the individual shareholder on $20 as a dividend but only on $15 as a capital gain, since the total amount taxed is limited by the amount of gain realized by the shareholder upon the cancellation or redemption of his stock.

ART. 112 (b) (7)–5. *Records to be kept and information to be filed with return.*—Permanent records in substantial form shall be kept by every qualified electing shareholder receiving distributions in complete liquidation of a domestic corporation. Such shareholder shall file with his income tax return for his taxable year in which the liquidation occurs a statement of all facts pertinent to the recognition and treatment of the gain realized by him upon the shares of stock owned by him on the date of the adoption of the plan of liquidation, including—

(*a*) A statement of his stock ownership in the liquidating corporation as of the date of the distribution, showing the number of shares of each class owned on such date and the cost or other basis of each such share;

(*b*) A list of all the property including money received upon the distribution, showing the fair market value of each item of such property other than money on the date distributed and stating what items, if any, consist of stock or securities acquired by the liquidating corporation after April 9, 1938;

(*c*) A statement of his ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, computed without diminution by reason of distributions made during the month of December, 1938; and

(*d*) A copy of such shareholder's written election to be governed by the provisions of section 112 (b) (7). (See article 112 (b) (7)–3.)

For information to be filed by the liquidating corporation, see section 148 (e).

[SEC. 112. *Recognition of gain or loss.*]

[(b) Exchanges solely in kind.—]

(8) *Exchanges and distributions in obedience to orders of securities and exchange commission.*—In the case of any exchange or distribution described in section 371, no gain or loss shall be recognized to the extent specified in such section with respect to such exchange or distribution.

[SEC. 112. *Recognition of gain or loss.*]

(c) *Gain from exchanges not solely in kind.*—(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

ART 112 (c)–1. *Receipt of other property or money in tax-free exchange not connected with corporate reorganization.*—If in any transaction in which (*a*) property held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment; or (*b*) common stock is exchanged for common stock, or preferred stock for preferred stock, in the same corporation and not in connection with a corporate reorganization; or (*c*) property is transferred by one or more persons to a corporation for its stock or securities, within the meaning of section 112 (b) (5), there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then

(1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

Example: A, who is not a dealer in real estate, in 1938 exchanges real estate, which he purchased (for investment) in 1921 for $5,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of $6,000, and he receives in addition $2,000 in cash. The gain from the transaction is $3,000, but is recognized only to the extent of the cash received of $2,000.

See article 113 (a) (6)–1 for the basis for determining the gain or loss from the subsequent sale of the property received in exchanges such as described in this article.

As to the receipt of other property or money on an exchange of stock or securities in connection with a reorganization, and as to distributions in pursuance of a plan of reorganization which have the effect of a taxable dividend, see article 112 (g)–4.

[SEC. 112. *Recognition of gain or loss.*]

(d) *Same—Gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(*e*) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

ART. 112 (e)–1. *Nonrecognition of loss.*—The Act provides that in no event shall a loss be recognized from a tax-free exchange of property under section 112

(b) (1) to (5), inclusive, notwithstanding the fact that there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss.

As to the effect on the basis of the property received in such an exchange for the purpose of determining gain or loss from the subsequent sale thereof, see article 113 (a) (6)-1.

As to the nonrecognition of loss upon the receipt of property by one corporation in complete liquidation of another corporation under certain specifically described circumstances, see section 112 (b) (6).

[SEC. 112. *Recognition of gain or loss.*]

(*f*) *Involuntary conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

ART. 112 (f)-1. *Reinvestment of proceeds of involuntary conversion.*—In order to avail himself of the benefits of section 112 (f) it is not sufficient for the taxpayer to show that subsequent to the receipt of money from a condemnation award he purchased other property similar or related in use. The taxpayer must trace the proceeds of the award into the payments for the property so purchased. It is not necessary that the proceeds be earmarked, but the taxpayer must be able to prove that the same were actually reinvested in such other property similar or related in use to the property converted. The benefits of section 112 (f) cannot be extended to a taxpayer who does not purchase other property similar or related in service or use, notwithstanding the fact that there was no other such property available for purchase.

If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens and mortgages against the property and itself pays the same, the amount so retained should be included in determining the amount of the net award. An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

The provisions of section 112 (f) are applicable to property used for residential or farming purposes.

The proceeds of a use and occupancy insurance contract, which by its terms insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

There is no investment in property similar in character and devoted to a similar use if—

(1) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

(2) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(3) The owner of a requisitioned tug uses the proceeds to buy barges.

(4) An award for property taken for street widening is applied toward payment of special assessments for benefits accruing to the remaining property.

It is incumbent upon a taxpayer "forthwith" to apply for and receive permission to establish a replacement fund in every case where it is not possible to replace immediately. If an expenditure in actual replacement would be too late, a request for the establishment of a replacement fund would likewise be too late.

ART. 112 (f)-2. *Replacement funds.*—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. See section 1126 of the Revenue Act of 1926, as amended (paragraph 35 of the Appendix to these regulations), providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. The estimated additional taxes, for the amount of which the applicant is required to furnish security, should be computed at the rates at which the applicant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

[SEC. 112. *Recognition of gain or loss.*]

(*g*) *Definition of reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

ART. 112 (g)-1. *Purpose and scope of exception of reorganization exchanges.*—*Purpose:* Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Act is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Act, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Act are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Act recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Act recognizes as a reorganization the amalgamation (occuring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the gen-

eral rule. Accordingly, under the Act, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

Scope: The nonrecognition of gain or loss is prescribed for two specifically described types of exchanges, viz: The exchange that is provided for in section 112 (b) (3) in which stock or securities in a corporation a party to the reorganization are, in pursuance of a plan of reorganization, exchanged for the stock or securities in a corporation a party to the same reorganization; and the exchange that is provided for in section 112 (b) (4) in which a corporation a party to the reorganization exchanges property, in pursuance of a plan of reorganization, for stock or securities in another corporation a party to the same reorganization. Section 112 (g) limits the definition of the term "reorganization" to five kinds of transactions and excludes all others. From its context, the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 112 (g). Certain rules respecting boot received in either of the two types of exchanges provided for in section 112 (b) (3) and (4) are prescribed in subsections (c) and (d) of section 112. Under section 112 (i) a limitation is placed on all these provisions by providing that except under specified conditions foreign corporations shall not be deemed within their scope.

The provisions of the Act referred to in the preceding paragraph of this article are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112 (g) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed. Such transaction and such acts must be an ordinary and necessary incident of the conduct of the enterprise and must provide for a continuation of the enterprise. A scheme which involves an abrupt departure from normal reorganization procedure, devised and adopted with reference to a transaction on which the imposition of the tax is imminent, is not a plan of reorganization.

ART. 112 (g)-2. *Definition of terms.*—The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange.

The words "statutory merger or consolidation" refer to a merger or consolidation effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia.

In order to qualify as a "reorganization" under section 112 (g) (1) (B), the acquisition by the acquiring corporation of the required amount of the stock, or of substantially all the properties, of the other corporation must be in exchange *solely* for all or a part of the *voting stock* of the acquiring corporation. If, for example Corporation X exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of the required amount of stock, or of the properties, of Corporation Y, the transaction is not a "reorganization" under section 112 (g) (1) (B).

A "recapitalization," and therefore a reorganization, takes place if, for example,

(1) A corporation with $200,000 par value of bonds outstanding, instead of paying them off in cash, discharges them by issuing preferred shares to the bondholders;

(2) There is surrendered to a corporation for cancellation 25 percent of its preferred stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock; or

(4) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights.

The term "a party to a reorganization" includes, in addition to a corporation which performs the specific act constituting the reorganization as described and defined in section 112 (g) (1), only a corporation specified in section 112 (g) (2). Both corporations are parties to the reorganization if under statutory authority Corporation A is merged into Corporation B; and all three of the corporations are parties to the reorganization if, pursuant to statutory authority, Corporations C and D are consolidated into Corporation E. Both corporations are parties to the reorganization if it consists of the transfer by Corporations F and G of part of the assets of Corporation F in exchange for all of the capital stock of Corporation G. Only Corporations H and J are parties to the reorganization if it consists of the acquisition by Corporation H in exchange solely for all or a part of its voting stock of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of stock of Corporation J, even though such acquisition by Corporation H is from Corporation K.

The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 112 (g) (1). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 112 (g) (1), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges as are directly a part of the transaction specifically described as a reorganization in that subsection. Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112 (g) (1), but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 112 (g) (1) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

As used in section 112, as well as in other provisions of the Act, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "stock *and* securities" are received in exchange as well as if "stock *or* securities" are received.

ART. 112 (g)-3. *Exchanges solely of stock or securities, or property, solely for stock or securities, in pursuance of plan of reorganization.*—No taxable income is received, nor is a deductible loss sustained, if the shareholders in a corporation a party to the following reorganization transactions exchange stock or securities solely for stock or securities of the same corporation, or of another corporation mentioned, or if one of such corporations transfers property to another of the corporations solely for stock or securities of such other corporation, in pursuance of the plan of reorganization:

(1) The merger of Corporation A, in accordance with statutory authority, into Corporation B;

(2) The consolidation, pursuant to statutory authority, of Corporations C and D into Corporation E, a new corporation;

(3) The acquisition by Corporation F, in exchange solely for all or a part of its voting stock, of at least 80 percent of the voting stock and at least 80 percent of the total number of shares of all other classes of the stock of Corporation G, or substantially all of the properties of Corporation G;

(4) The transfer by Corporation H of all or a part of its assets to Corporation K, if immediately after the transfer Corporation H or its stockholders, or both, are in control of Corporation K ("control" for the purpose of this transaction being defined in section 112 (h) as the

ownership by Corporation H or its stockholders, or both, of the stock of Corporation K to the extent of at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes thereof); or

(5) The exchange of stock or securities solely for stock or securities of the same corporation in the case of (*a*) a recapitalization of a corporation, or (*b*) a mere change in the identitfy, form, or place of organization of a corporation, however effected.

ART. 112 (g)-4. *Exchanges in reorganization for stock or securities and other property or money.*—If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112 (c) (1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112 (e)).

Example: A, in connection with a reorganization, in 1938, exchanges a share of stock in the X Corporation purchased in 1928 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

If the distribution of such other property or money by or on behalf of a corporation in the course of a reorganization has the effect of the distribution of a taxable dividend, then, as provided in section 112 (c) (2), there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized on the exchange as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain so recognized.

Example: The X Corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X Corporation in 1938 transfers all of its assets to the Y Corporation in exchange for the issuance of all of the stock of the Y Corporation and the payment of $50,000 in cash to the stockholders of the X Corporation. A, who owns one share of stock in the X Corporation, for which he in 1928 paid $100, receives a share of stock in the Y Corporation worth $100 and the sum of $50 in cash in addition. A gain of $50 is recognized to A.

If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to the reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, as provided in section 112 (d) (1), if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized, under the provisions of section 112 (d) (2), in an amount not in excess of the sum of money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized (see section 112 (e)).

ART. 112 (g)-5. *Receipt of stock or securities in reorganization without surrender of stock by shareholder.*—Any distribution, though in pursuance of a plan of reorganization, to its shareholders without the surrender of their stock, by or on behalf of a corporation a party to a reorganization, of its stock or securities (other than its own stock, which is not taxable as a dividend under section 115 (f)) or of stock or securities of another corporation a party to the reorganization, shall be taxed to such shareholders as a dividend, within the meaning of section 115, to the extent that the fair market value of such stock or securities at the date of the distribution is not in excess of (1) the earnings or profits of the corporation of the taxable year computed without regard to prior years and (2) the earnings or profits of the corporation accumulated after February 28, 1913, and prior to the taxable year. Any remainder of such fair market value of the stock or securities distributed over the amount of such earnings or profits shall be applied against and used to reduce the basis provided in section 113 of the stock in respect of which the distribution was made; and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. (See article 111-1.)

ART. 112 (g)-6. *Records to be kept and information to be filed with returns.*—(*a*) The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation. Each corporation a party to a reorganization shall file as a part of its return for its taxable year within which the reorganization occurred a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the reorganization, including—

1. A certified copy of the plan of reorganization, together with a statement under oath showing in full the purposes thereof and in detail all transactions incident to, or pursuant to, the plan.

2. A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan.

3. A statement of the amount of stock or securities and other property or money received from the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities and other property received shall be stated on the basis of the fair market value thereof at the date of the exchange.

(*b*) Every taxpayer, other than a corporation a party to the reorganization, who receives stock or securities and other property or money upon a tax-free exchange in connection with a corporate reorganization shall incorporate in his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange, including—

1. A statement of the cost or other basis of the stock or securities transferred in the exchange, and

2. A statement in full of the amount of stock or securities and other property or money received from the exchange. The amount of each kind of stock or securities and other property received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

(*c*) Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received, in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

[SEC. 112. *Recognition of gain or loss.*]

(*h*) *Definition of control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

ART. 112 (h)-1. *Control of corporation.*—Section 112 (h) defines the term "control" in reference to the phrase "control of the corporation," as used in section 112 (b) (5) and section 112 (g) (1). It is provided specifically that this

definition is limited to the meaning of the term "control" as that term is used in section 112.

[SEC. 112. *Recognition of gain or loss.*]
(*i*) *Foreign corporations.*—In determining the extent to which gain shall be recognized in the case of any of the exchanges described in subsection (b) (3), (4), (5), or (6), or described in so much of subsection (c) as refers to subsection (b) (3) or (5), or described in subsection (d), a foreign corporation shall not be considered as a corporation unless, prior to such exchange, it has been established to the satisfaction of the Commissioner that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

ART. 112 (i)-1. *Reorganization with, or transfer of property to, a foreign corporation.*—A foreign corporation will not be considered a corporation to which a tax-free transfer of property for stock or securities may be made, or a corporation a party to a reorganization with which a tax-free reorganization exchange may be made, or a corporation a party to which a tax-free liquidation distribution may be made, unless, prior to the transfer, exchange, or liquidation, it has been established to the satisfaction of the Commissioner that such transfer, exchange, or liquidation, is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. The term "Federal income taxes" includes the excess-profits tax on the net income of a corporation referred to in section 106 of the Revenue Act of 1935, section 402 of the Revenue Act of 1936, and section 602 of the Revenue Act of 1938.

Whether any of the exchanges or distributions referred to in section 112 (i), involving a foreign corporation, is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income or excess-profits taxes, is a question to be determined from the facts and circumstances of each particular case. In any such case if a taxpayer desires to establish that the exchange or distribution is not in pursuance of such a plan, a statement under oath of the facts relating to the plan under which the exchange or distribution is to be made, together with a copy of the plan, shall be forwarded to the Commissioner of Internal Revenue, Washington, D. C., for a ruling. A letter setting forth the Commissioner's determination will be mailed to the taxpayer. If the Commissioner determines that the exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income or excess-profits taxes, the taxpayer should retain a copy of the Commissioner's letter as authority for treating the foreign corporation as a corporation in determining the extent to which gain is recognized from the exchange or distribution. If the reorganization or the transfer is not carried out in accordance with the plan submitted, the Commissioner's approval will not render the transaction tax-free.

[SEC. 112. *Recognition of gain or loss.*]
(*j*) *Installment obligations.*—For nonrecognition of gain or loss in the case of the installment obligations, see section 44 (d).

SEC. 113. *Adjusted basis for determining gain or loss.*—(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

ART. 113 (a)-1. *Scope of basis for determining gain or loss.*—The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in section 113 (a), adjusted for the various applicable items specified in section 113 (b). Unless otherwise indicated, the word "basis," as used in this article and articles 113 (a)-2 to 113 (a) (18)-1, inclusive, has reference to the unadjusted basis.

ART. 113 (a)-2. *General rule.*—In general, the basis of property is the cost thereof. This rule is subject, however, to the exceptions stated in paragraphs (1) to (18) of section 113 (a).

[SEC. 113. *Adjusted basis for determining gain or loss.*]
[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(1) *Inventory value.*—If the property should have been included in the last inventory, the basis shall be the last inventory value thereof.

ART. 113 (a) (1)-1. *Property included in inventory.*—The last inventory value of property which should be included in inventory is the basis of such property. The requirements with respect to the valuation of an inventory are stated in articles 22 (c)-1 to 22 (d)-4, inclusive.

[SEC. 113. *Adjusted basis for determining gain or loss.*]
[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(2) *Gifts after December 31, 1920.*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that for the purpose of determining loss the basis shall be the basis so determined or the fair market value of the property at the time of the gift, whichever is lower. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner.

ART. 113 (a) (2)-1. *Property transmitted by gift after December 31, 1920—(a) Property included.*—Section 113 (a) (2) applies to all property acquired after December 31, 1920, by gift, whether by transfer in trust or otherwise. It does not apply to property acquired by

(1) devise or bequest (see section 113 (a) (5)); or

(2) an instrument which, under section 113 (a) (5), is to be treated as though it were a will.

Section 113 (a) (2) applies to all gifts of whatever description; whether by a transfer in trust or otherwise; whenever and however made, perfected, or taking effect; whether in contemplation of or intended to take effect in possession or enjoyment at or after the donor's death; whether subject at any time to any change through the exercise of any power of appointment, revocation or otherwise; or whether made by means of the exercise (other than by will) of a power of appointment or revocation, or any other power.

(*b*) *Basis.*—For the purpose of determining gain, the basis is the same as it would be in the hands of the donor, or the last preceding owner by whom it was not acquired by gift. For the purpose of determining loss, the basis is as so determined, or the fair market value of the property at the time of the gift, whichever is lower.

All titles to property acquired by gift relate back to the time of the gift, even though the interest of him who takes the title was, at the time of the gift, legal, equitable, vested, contingent, conditional, or otherwise. Accordingly, all property acquired by gift is acquired at the time of the gift. In the hands of every person acquiring property by gift, the basis is always the same, whether such person be the trustee under the gift instrument, the beneficiary, or any other person to whom such uniform basis is applicable, and whether during the term of the trust or after distribution of the trust corpus. Adjustments to basis, as required by section 113 (b), are to be made as respects the period prior to the gift, and the period after the gift. With respect to the latter period, the adjustments to the uniform basis are to be made in accordance with paragraph (*e*) of article 113 (a) (5)-1.

The time of the gift is the time when the gift is consummated. Delivery, actual or constructive, is requisite to a gift. In determining the time of the gift, the passing of title by the donor is not decisive; the time when the donor relinquishes substantial dominion over the property is decisive.

(*c*) *Fair market value.*—For the purposes of this article, the value of property as appraised for the purpose of the Federal gift tax, or if the gift is not subject to such tax, its value as appraised for the purpose of a State gift tax shall be deemed to be the fair market value of the property at the time of the gift.

(*d*) *Reinvestments by fiduciary.*—If the property is an investment by the fiduciary under the instrument of gift (as, for example, in the case of a sale by the fiduciary of property transferred

under the instrument of gift, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the basis specified in paragraph (*b*).

(*c*) *Records.*—To insure a fair and adequate determination of the proper basis under section 113 (a) (2), persons making or receiving gifts of property should preserve and keep accessible a record of the facts necessary to determine the cost of the property and, if pertinent, its fair market value as of March 1, 1913.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(3) *Transfer in trust after December 31, 1920.*—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

ART. 113 (a) (3)–1. *Transfer in trust after December 31, 1920.*—(*a*) *Property included.*—Section 113 (a) (3) applies in general to all property acquired after December 31, 1920, by transfer in trust. It does not apply to property acquired as a *gift* by transfer in trust, or by bequest or devise; or by an instrument which, under section 113 (a) (5), is to be treated as though it were a will. With these exceptions, section 113 (a) (3) applies to all property acquired after December 31, 1920, by any transfer in trust of whatever description. If the transfer in trust be a gift, it is not within section 113 (a) (3), but is within section 113 (a) (2) or section 113 (a) (4).

(*b*) *Basis.*—The basis of property so acquired is the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether prior to the termination of the trust and distribution of the property, or thereafter.

(*c*) *Reinvestments by fiduciary.*—If the property is an investment made by the fiduciary (as, for example, in the case of a sale by the fiduciary of property transferred by the grantor, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the basis specified in paragraph (*b*).

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(4) *Gift or transfer in trust before January 1, 1921.*—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition.

ART. 113 (a) (4)–1. *Gift or transfer in trust prior to January 1, 1921.*—(*a*) *Property included.*—Section 113 (a) (4) applies to all property acquired before January 1, 1921, by gift or transfer in trust. It does not apply to property acquired by a devise or bequest; or by an instrument which, under section 113 (a) (5) is to be treated as though it were a will.

(*b*) *Basis.*—The basis is the fair market value of such property at the time of the gift or at the time of the transfer in trust. Such fair market value is to be ascertained in the manner prescribed in paragraph (*c*) of article 113 (a) (2)–1, or by equivalent methods.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. For the purpose of this paragraph property passing without full and adequate consideration under a general power of appointment exercised by will shall be deemed to be property passing from the individual exercising such power by bequest or devise. If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, and if the decedent died after August 26, 1937, and if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year next preceding the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company, then the basis shall be the fair market value of such property at the time of such acquisition or the basis in the hands of the decedent, whichever is lower.

ART. 113 (a) (5)–1. *Basis of property acquired by bequest, devise, or inheritance.*—(*a*) *Property included.*—Section 113 (a) (5) applies—

(1) to all property passing from a decedent by his will or under the law governing the descent and distribution of property of decedents; and

(2) to property passing under an instrument which, under section 113 (a) (5) is treated as though it were a will, but applies to such property only at the times and to the extent prescribed in section 113 (a) (5).

(*b*) *Basis.*—Section 113 (a) (5) provides two rules for determining the basis of property transmitted at death, a rule governing property generally and a special rule governing stock in a foreign personal holding company.

(1) *General rule.*—Except as prescribed in paragraph (2) the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. For example, if distribution of personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair market value at the time when the decedent died, and not when the legatee actually received the property; or, if the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies; or, if the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died.

The purpose of the Act, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

(2) *Special rule with respect to stock in a foreign personal holding company.*—In the case of decedents dying after August 26, 1937, the basis of stock of a foreign corporation acquired from the

decedent by will or under the law governing descent and distribution of property of decedents, where such foreign corporation with respect to its taxable year next preceding the date of the decedent's death was a foreign personal holding company, is the fair market value of such stock at the time of such acquisition, i. e., the date of the decedent's death, or the basis in the hands of the decedent (with proper adjustments to the date of the decedent's death), whichever is lower.

(c) *Fair market value.*—For the purposes of this article, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or if the property is not appraised as of the date of death of the decedent for such purpose or if the estate is not subject to such tax, its value as appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of the death of the decedent.

(d) *Property acquired before March 1, 1913; reinvestments by fiduciary.*—If the decedent died before March 1, 1913, the fair market value on that date is taken in lieu of the fair market value on the date of death, but only to the same extent and for the same purposes as the fair market value on March 1, 1913, is taken under section 113 (a) (14).

If the property is an investment by the fiduciary under a will (as, for example, in the case of a sale by a fiduciary under a will of property transmitted from the decedent, and the reinvestment of the proceeds), the cost or other basis to the fiduciary is taken in lieu of the fair market value at the time when the decedent died.

(e) *Adjustments to basis.*—In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or inheritance, the basis of the property is always the same,

(1) whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be;

(2) whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. Thus the deductions for depreciation and for depletion allowed or allowable, under section 23 (l) and section 23 (m), to a legal life tenant as if the life tenant were the absolute owner of the property, constitute an adjustment to the basis of the property in the hands not only of the life tenant, but also in the hands of the remainderman and every other person to whom the same uniform basis is applicable. Similarly, the deductions allowed or allowable under section 23 (l) and section 23 (m), both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands of the trustee, but also in the hands of the trust beneficiaries and every other person to whom the uniform basis is applicable. See, however, section 24 (a). Similarly, adjustments in respect of capital expenditures or losses, tax-free distributions, or other distributions applicable in reduction of basis, or other items for which the basis is adjustable are made without regard to which one of the persons to whom the same uniform basis is applicable makes the capital expenditures or sustains the capital losses, or to whom the tax-free or other distributions are made, or to whom the deductions are allowed or allowable.

The executor or other legal representative of the decedent, the fiduciary of a trust under a will, the life tenant and every other person to whom a uniform basis under this article is applicable, shall make and maintain records showing in detail all deductions, distributions, or other items for which adjustment to basis is required to be made by section 113 (b), and shall furnish to the Commissioner information with respect to such matters in such detail at such time and in such manner as the Commissioner may require.

(f) *Sales of remainder and other interests in property transmitted at death.*—The following is an illustration of the rule stated in paragraph (b) of this article that, under section 113 (a) (5), the measure of gain or loss resulting from a sale or other disposition of property transmitted at death is the increase or decrease in the value of the property as reflected in such sale or other disposition: If land is left for life to A, with remainder in fee to B, and prior to A's death, B sells his remainder, the increase or decrease in the value of the land reflected, and realized by B, in the proceeds from the sale of his remainder interest constitutes the gain recognized upon the sale. (See section 111.) Such gain (or as the case may be, the loss) is computed by comparing the amount of the proceeds received from the sale with the amount of the part of the uniform basis assignable to such sale of B's remainder interest. The part of the uniform basis assignable to such a sale by B is the part of the uniform basis (adjusted to the time of the sale) of the land transmitted from the decedent which bears the same proportion to such uniform basis as B's remainder interest, at the time of the sale, bears to the whole estate in the land transmitted from the decedent.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(6) *Tax-free exchanges generally.*—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis (except as provided in paragraph (15), (17), or (18) of this subsection) shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

ART. 113 (a) (6)–1. *Property acquired upon a tax-free exchange.*—In the case of an exchange, after February 28, 1913, of property solely of the type described in section 112 (b), if no part of the gain or loss was recognized under the law applicable to the year in which the exchange was made, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange.

If, in an exchange, after February 28, 1913, of properties of the type indicated in section 112 (b), gain to the taxpayer was recognized under the provisions of section 112 (c) or (d) or a similar provision of a prior Revenue Act, on account of the receipt of money in addition in the transaction, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange), decreased by the amount of money received and increased by the amount of gain recognized on the exchange. For example: A purchased a share of stock in the X Corporation in 1926 for $100. Pursuant to a plan of reorganization, A in 1938 exchanged his share for one share in the Y Corporation, worth $90, and $30 in cash. Under the provisions of section 112 (c), A realized a taxable gain of $20 from the exchange. As to the amount of such gain to be taken into account in computing net income, see section 117. The basis of the share of stock in the Y Corporation is $90; that is, the basis of the share in the X Corporation ($100) less the amount of money received by A ($30) plus the amount of gain recognized on the exchange ($20).

If, upon an exchange of properties of the type described in section 112 (b), there was received by the taxpayer in addition other property (not permitted to be received without the recognition of gain) and money, and gain from the transaction was recognized as required under section 112 (c) or (d) or a similar provision of a prior Revenue Act, the basis (adjusted to the date of the ex-

change of the property transferred by the taxpayer, decreased by the amount of money received and increased by the amount of gain recognized, must be apportioned to and is the basis of the properties (other than money) received on the exchange. For the purpose of the allocation of such basis to the properties received, there must be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Example: A purchased a share of stock in the X Corporation in 1924 for $100. Upon a reorganization of the X Corporation in 1938, A received in place of his stock in the X Corporation a share of stock in the Y Corporation worth $60, a Treasury bond worth $50, and in addition $20 in cash. Under section 112 (c) (1), A realized a gain of $30 from the exchange. As to the amount of such gain to be taken into account in computing net income, see section 117. The basis of the property received in exchange is the basis of the old stock ($100) decreased in the amount of money received ($20) and increased in the amount of gain that was realized ($30), which results in a basis for the property received of $110. This basis of $110 is apportioned between the Treasury bond and the share of stock, the basis of the Treasury bond being its fair market value at the date of the exchange, $50, and of the share of stock, the remainder, $60.

Section 112 (e) of the Act, and similar provisions of prior Revenue Acts, provide that no loss may be recognized on an exchange of properties of a type described in section 112 (b), although the taxpayer receives other property or money from the transaction. However, the basis of the property or properties received by the taxpayer (other than money) is the basis (adjusted to the date of the exchange) of the property transferred, decreased by the amount of money received. This basis must be apportioned to the properties received, and for this purpose there must be allocated to such other property (not permitted to be exchanged tax free) an amount of such basis equivalent to the fair market value of such other property at the date of the exchange.

Paragraph (6) of section 113 (a) does not apply in ascertaining the basis of property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it. But see paragraphs (7) and (8) of section 113 (a).

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(7) *Transfers to corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

ART. 113 (a) (7)–1. *Property acquired by corporation in reorganization after December 31, 1917.*—Section 113 (a) (7) sets forth the conditions under which the basis of property acquired by a corporation after December 31, 1917, in connection with a reorganization as defined in section 112 is the same as it would be in the hands of the transferor, increased or decreased as therein provided in the amount of gain or loss recognized to the transferor under the applicable revenue law. In the case of property so acquired in a taxable year beginning prior to January 1, 1936, such basis is applicable only if immediately after the transfer there remained in the same persons or any of them an interest or control in such property of 50 percent or more. In the case, however, of property so acquired in a taxable year beginning after December 31, 1935, section 113 (a) (7) is applicable irrespective of the extent of the interest or amount of control in such property remaining, immediately after the transfer, in the hands of the same persons or any of them.

The application of the provisions of section 113 (a) (7) (A) may be illustrated by the following examples:

Example (1): In 1925 the X Corporation caused the organization of the Y Corporation and transferred to the Y Corporation, in exchange for all the capital stock of that corporation, property which it had previously purchased for $10,000. The basis of the property in the hands of the Y Corporation is $10,000.

Example (2): In 1925 the M Corporation exchanged 10 percent of its voting stock for all the property of the N Corporation which had a basis of $10,000 in the hands of the N Corporation. The basis of the property in the hands of the M Corporation is cost thereof to it at the time of the transfer, that is, the fair market value of the M stock exchanged for the property.

Section 113 (a) (7) does not apply if, irrespective of when acquired, the property consists of stock or securities in a corporation a party to a reorganization as defined in section 112, unless such stock or securities are acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer. The application of the last sentence of section 113 (a) (7) to a case where such stock or securities are acquired by the issuance of stock or securities of the transferee may be illustrated as follows:

Example (3): The Y Corporation owns all of the stock of the X Corporation, which stock it acquired in 1938 by the issuance of all of its own voting stock to the individual shareholders of the X Corporation. The stock of the X Corporation was acquired by the individuals in 1924 for $200,000 in cash. The stock of the Y Corporation had a fair market value of $1,000,000 at the time it was exchanged in 1938 for the stock of the X Corporation. The fair market value of the stock of the X Corporation at the time of the exchange in 1938 was also $1,000,000. The basis to the Y Corporation of the stock of the X Corporation is the basis which such stock would have had in the hands of the individuals from which it was acquired by the Y Corporation, that is, $200,000.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

ART. 113 (a) (8)–1. *Property acquired by a corporation after December 31, 1920.*—The acquisition of property by a corporation after December 31, 1917, by the issuance of its stock or securities may not fall within the provisions of paragraph (7) of section 113 (a), because of the fact that the property was not acquired in connection with a reorganization. If, however, the acquisition of such property occurred after December 31, 1920, and falls within the provisions of paragraph (8) of section 113 (a), the limitations therein imposed upon the basis of such property are applicable.

In respect of property acquired by a corporation after December 31, 1920, from a shareholder as paid-in surplus, or from any person as a contribution to capital, the basis of the property in the hands of the corporation is the basis which the property would have had in the hands of the transferor if the transfer had not been made. In the case of property acquired by a corporation after December 31, 1920, as a gift, the basis thereof shall be determined under section 113 (a) (2).

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(9) *Involuntary conversion.*—If the property was acquired, after February 28, 1913, as a result of a compulsory or involuntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

ART. 113 (a) (9)-1. *Property acquired as a result of an involuntary conversion.*—The provisions of section 113 (a) (9) may be illustrated by the following example:

Example: A vessel purchased by A in 1926 for $100,000 is destroyed in 1938 and A receives insurance in the amount of $200,000. Disregarding, for the purpose of this example, the adjustment for depreciation, if A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized. The basis of the new vessel is $100,000; that is, the cost of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(10) *Wash sales of stock.*—If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this Act or corresponding provisions of prior income tax laws, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired and the price at which such substantially identical stock or securities were sold or otherwise disposed of.

ART. 113 (a) (10)-1. *Stocks or securities acquired in "wash sales."*—The application of section 113 (a) (10) may be illustrated by the following examples:

Example (1): A purchased a share of common stock of the X Corporation for $100 in 1926, which he sold January 15, 1938, for $80. On February 1, 1938, he purchased a share of common stock of the same corporation for $90. No loss from the sale is recognized under section 118. The basis of the new share is $110; that is, the basis of the old share ($100) increased by $10, the excess of the price at which the new share was acquired ($90) over the price at which the old share was sold ($80).

Example (2): A purchased a share of common stock of the Y Corporation for $100 in 1926, which he sold January 15, 1938, for $80. On February 1, 1938, he purchased a share of common stock of the same corporation for $70. No loss from the sale is recognized under section 118. The basis of the new share is $90; that is, the basis of the old share ($100) decreased by $10, the excess of the price at which the old share was sold ($80) over the price at which the new share was acquired ($70).

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(11) *Property acquired during affiliation.*—In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to intercompany transactions in respect of which gain or loss was not recognized. For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936, shall be determined in accordance with regulations prescribed under section 141 (b) of this Act or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936, shall be adjusted in respect of any items relating to such period, in accordance with regulations prescribed under section 141 (b) of this Act or the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936, applicable to such period.

ART. 113 (a) (11)-1. *Basis of property acquired during affiliation.*—The basis of property acquired by a corporation during a period of affiliation from a corporation with which it was affiliated shall be the same as it would be in the hands of the corporation from which acquired. This rule is applicable if the basis of the property is material in determining tax liability for any year, whether a separate return or a consolidated return is made in respect of such year. For the purpose of this article, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto, but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

Example: The X Corporation, the Y Corporation, and the Z Corporation were affiliated for the taxable year 1920. During that year the X Corporation transferred assets to the Y Corporation for $120,000 cash, and the Y Corporation in turn transferred the assets during the same year to the Z Corporation for $130,000 cash. The assets were acquired by the X Corporation in 1916 at a cost of $100,000. The basis of the assets in the hands of the Z Corporation is $100,000.

The basis of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return was made or was required under Regulations 75, Regulations 78, Regulations 89, Regulations 97, or Regulations 102, relating to consolidated returns, shall be determined in accordance with such regulations. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made or is required under Regulations 75, Regulations 78, Regulations 89, Regulations 97, or Regulations 102, shall be adjusted in respect of any items relating to such period in accordance with such regulations.

The basis of property after a consolidated return period shall be the same as immediately prior to the close of such period. For example, if a corporation has been a member of an affiliated group which has made a consolidated return on the calendar year basis for the taxable year 1937 and makes a separate return for the taxable year 1938 and succeeding taxable years, the value of the opening inventory to be used in computing such corporation's net income for the taxable year 1938 is the proper value of the closing inventory used in computing the consolidated net income for the preceding taxable year.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(12) *Basis established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

ART. 113 (a) (12)-1. *Basis of property established by Revenue Act of 1932.*—Section 113 (a) (12) provides that if the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis of the property, for the purposes of the

Revenue Act of 1932, was prescribed by section 113 (a) (6), (7), or (9) of that Act, then for the purposes of the Revenue Act of 1938 the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

If, after December 31, 1923, and in any taxable year beginning prior to January 1, 1934, in pursuance of a plan of reorganization and without the surrender of his stock, there was distributed to a shareholder in a corporation a party to the reorganization stock or securities of a corporation a party to the reorganization, then as is provided in section 113 (a) (9) of the Revenue Act of 1932, the basis of the stock in respect of which the distribution was made must be apportioned between such stock and the stock or securities so distributed to the shareholder. The basis of the old shares and the new shares or securities shall be determined in accordance with the following rules:

(1) If the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and the new shares.

(2) If the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or if the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security to which such share or unit belongs, divided by the number of shares or units in the class Within the meaning of the foregoing provisions, securities are different in class from stocks and stocks or securities in one corporation are different in class from stocks or securities in another corporation. In general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

(3) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 22 (a)-8), and any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

(4) If the stock in respect of which a distribution in reorganization is made was purchased at different times or at different prices, and the stock or securities distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

If in any taxable year beginning after December 31, 1937, without the surrender of his stock there is acquired by a shareholder in a corporation a party to a reorganization, as a distribution in pursuance of the plan of reorganization, stock or securities in a corporation a party to the reorganization, such acquisition of new shares or securities by the shareholder will be treated as a dividend to the extent described in article 112 (g)-5.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(13) *Partnerships.*—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

ART. 113 (a) (13)-1. *Property contributed in kind by a partner to a partnership.*—The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation are to be computed on such basis. If such basis is greater than the fair market value of the property at the date of the transfer to the partnership, the annual depletion or depreciation allowances shall be allocated to and included in the determination of the distributive shares of the partners in accordance with their agreement in respect of the sharing of gains or losses affecting partnership capital. If the basis of such contributed property is less than the fair market value thereof at the date of transfer to the partnership, the annual allowances for depletion and depreciation are to be limited to such basis and may be apportioned among the partners according to their agreement with respect to the sharing of gains or losses affecting partnership capital. On the sale or other disposition of such contributed property by the partnership the gain or loss, determined on such transferred basis, adjusted as required by section 113 (b), shall be prorated in determining the distributive shares of the partners according to their gain or loss ratios on the disposition of a partnership asset under the partnership agreement.

ART. 113 (a) (13)-2. *Readjustment of partnership interests.*—When a partner retires from a partnership, or the partnership is dissolved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost or other basis as hereinbefore provided and the value of such interest as of such date, plus the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained, and the gain derived or the loss sustained shall be computed as provided in article 111-1. See also section 117. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. The basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

If a new partner is admitted to the partnership, or an existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain has been realized or loss sustained by any partner.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(14) *Property acquired before March 1, 1913.*—In the case of property acquired before March 1, 1913, if the basis otherwise determined under this subsection, adjusted (for the period prior to March 1, 1913) as provided in subsection (b), is less than the fair market value of the property as of March 1, 1913, then the basis for determining gain shall be such fair market value. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

ART. 113 (a) (14)-1. *Property acquired prior to March 1, 1913.*—The basis as of March 1, 1913, for determining gain in the case of property acquired prior to that date, is the basis otherwise provided for such property under section 113 (a), adjusted for the period prior to

March 1, 1913, or the fair market value of the property as fo March 1, 1913, whichever is higher.

The basis as of March 1, 1913, for determining loss in the case of property acquired prior to that date is the cost or other basis provided for such property under section 113 (a) adjusted as required by section 113 (b), but without reference to the fair market value of the property as of March 1, 1913.

Example: A, who makes his returns upon the calendar year basis, in 1908 purchased property for $100,000. Assuming, for the purposes of this example, that there are no additions and betterments to be taken into account, the depreciation sustained on the property prior to March 1, 1913, was $10,000, so that the original cost adjusted as of March 1, 1913, for depreciation sustained prior to that date was $90,000. As of that date the fair market value of the property was $94,000. (*a*) For the purpose of determining gain from the sale or other disposition of the property on March 1, 1938, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If it be assumed that the amount of depreciation deductions allowed (not less than the amount allowable) after February 28, 1913, to the year 1938 is in the aggregate sum of $43,240, the adjusted basis for determining gain in 1938 ($94,000 less $43,240) is $50.760. (*b*) For the purpose of determining a loss from the sale or other disposition of such property in 1938, the basis of the property is the cost of the property, without reference to the fair market value as of March 1, 1913, adjusted for depreciation before March 1, 1913, and after February 28, 1913. The amount of depreciation sustained prior to March 1, 1913, in this example is $10,000, and if the amount of depreciation to be accounted for after February 28, 1913, is assumed to be $43,240, the aggregate amount of depreciation for which adjustment of such cost must be made is $53,240. The adjusted basis for determining the loss in 1938 ($100,000 less $53,240) is $46,760.

What the fair market value of property was on March 1, 1913, is a question of fact to be established by competent evidence. In determining the fair market value of stock in a corporation, due regard shall be given to the fair market value of the corporate assets on such date. In the case of property traded in on public exchanges, actual sales at or about the basic date afford evidence of value. In general, the fair market value of a block or aggregate of a particular kind of property is not to be determined by a forced sale price or by an estimate of what a whole block or aggregate would bring if placed upon the market at one and the same time, but such value should be determined by ascertaining as the basis the fair market value of each unit of the property. All relevant facts and elements of value as of the basic date should be considered in every case.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(15) *Property received by a corporation on complete liquidation of another.*—If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113 (a) (15) of the Revenue Act of 1936, as amended, shall, in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended.

ART. 113 (a) (15)–1. *Basis of property received by a corporation in complete liquidation of another corporation.*—Except as otherwise provided in this article, the basis of property received in complete liquidation, without the recognition of gain or loss as provided in section 112 (b) (6), shall be the same as the basis of the property in the hands of the liquidating corporation with proper adjustments as provided in section 113. See section 113 (b).

In the case of property received in liquidation after December 31, 1935, and before June 23, 1936, in a taxable year of the recipient corporation beginning after December 31, 1935, the basis of such property in the hands of the recipient corporation shall be the basis prescribed by section 113 (a) (6) of the Revenue Act of 1934, as amended by the Revenue Act of 1935, if—

(1) Such property was received in a liquidation which was completed before June 23, 1936;

(2) Such liquidation constituted a complete liquidation within the meaning of section 112 (b) (6) of the Revenue Act of 1934, as added by the Revenue Act of 1935;

(3) No gain or loss would have been recognized under section 112 (b) (6) of the Revenue Act of 1934, as amended, upon the receipt of such property; and

(4) The recipient corporation (within 180 days after the enactment of the Revenue Act of 1938) under regulations prescribed under section 808 elected to have such basis apply to such property.

If such an election was made, the basis of such property received in liquidation shall be the cost or other basis (adjusted as provided in section 113) of the stock of the liquidating corporation surrendered in exchange for the property, decreased in the amount of money received and increased in the amount of gain or decreased in the amount of loss to the recipient corporation that was recognized upon the liquidation under the Revenue Act of 1936. If such property consists of more than one class of property the basis shall be allocated among the several properties (other than money) received, in the proportion that the fair market value of each such property as of the date of distribution bears to the fair market value of all such properties on that date.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(16) *Basis established by Revenue Act of 1934.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1936, and the basis thereof, for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934.

ART. 113 (a) (16)–1. *Basis of property established by Revenue Act of 1934.*—Section 113 (a) (16) provides that if property was acquired after February 28, 1913, in any taxable year beginning prior to January 1, 1936, and the basis of the property for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of that Act, then for the purposes of the Revenue Act of 1938 the basis shall be the same as the basis therein prescribed under the Revenue Act of 1934. For example, if after December 31, 1920, and in any taxable year beginning prior to January 1, 1936, property was acquired by a corporation by the issuance of its stock or securities in connection with a transaction which is not described in section 112 (b) (5) of the Act but which is described in section 112 (b) (5) of the Revenue Act of 1934, the basis of the property so acquired shall be the same as it would be in the hands of the transferor, with proper adjustments to the date of the exchange.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

[(*a*) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—]

(17) *Property acquired in connection with exchanges and distributions in obedience to certain orders of Securities and Exchange Commission.*—If the property was acquired in any manner described in section 372, the basis shall be that prescribed in such section with respect to such property.

(18) *Property received in certain corporate liquidations.*—If the property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock with respect to which gain was realized, but with respect to which, as the result of an election made by him under paragraph (7) of section 112 (b), the extent to which gain was recognized was determined under such paragraph, then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by him, and increased in the amount of gain recognized to him.

ART. 113 (a) (18)–1. *Basis of property received in certain corporate liquidations.*—(*a*) *Property included.*—Section 113 (a) (18) applies only to property (other than money) acquired (1) by a qualified electing shareholder, (2) upon a distribution in complete liquidation of a

domestic corporation pursuant to a plan of liquidation adopted after May 28, 1938, in accordance with which the distribution is in complete cancellation or redemption of all the stock and the transfer of all the property in the liquidation occurs within the month of December, 1938, and (3) in cancellation or redemption of only those shares of stock which were owned by such qualified electing shareholder on the date of the adoption of the plan of liquidation and on which he realizes gain. It applies to all the property, except money, so acquired, though such property may consist in whole or in part of stock or securities acquired by the liquidating corporation after April 9, 1938.

(b) *Basis.*—The basis of such property so acquired is the same as the basis of the shares of stock, in cancellation or redemption of which such property was received, with proper adjustments to the date of acquisition, decreased in the amount of such shares' ratable share of any money received in cancellation or redemption of shares of the same class, and increased in the amount of gain recognized under the provisions of section 112 (b) (7). If such property consists of more than one class of property, the basis shall be allocated among the several properties (other than money) acquired in the proportion that the fair market value of each such property as of the date of acquisition bears to the fair market value of all such properties on that date. The application of this paragraph may be illustrated by the following example:

Example: The X Corporation distributed all its property in complete liquidation during the month of December, 1938, pursuant to the provisions of section 112 (b) (7). A, an individual and a qualified electing shareholder, received, in cancellation or redemption of 100 shares of stock owned by him on the date of the adoption of the plan of liquidation, $1,000 in cash, property (other than stock or securities acquired by the corporation after April 9, 1938) with a fair market value of $12,000, and stock acquired by the liquidating corporation after April 9, 1938, with a fair market value of $4,000. The basis of the shares owned by A was $100 per share, or $10,000. A's ratable share of the earnings and profits of the X Corporation accumulated after February 28, 1913 (computed as provided in section 112 (b) (7)), was $2,500. His gain is $7,000, but under section 112 (b) (7) only $5,000 of this gain is recognized, $2,500 thereof being taxed as a dividend. The basis of all the property other than money received by A is $14,000, computed as follows:

Adjusted basis of stock canceled or redeemed	$10,000
Less money received	1,000
Remainder	9,000
Plus gain recognized	5,000
Basis of property acquired	14,000

This basis will be apportioned among the classes of property (other than money) received as follows: 12,000/16,000 of $14,000, or $10,500, to the property other than stock; 4,000/16,000 of $14,000, or $3,500, to the stock.

[SEC. 113. *Adjusted basis for determining gain or loss.*]

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

(C) in respect of any period prior to March 1, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent sustained;

(D) in the case of stock (to the extent not provided for in the foregoing subparagraphs) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921);

(E) to the extent provided in section 337 (f) in the case of the stock of United States shareholders in a foreign personal holding company; and

(F) to the extent provided in section 28 (h) in the case of amounts specified in a shareholder's consent made under section 28.

(2) *Substituted basis.*—The term "substituted basis" as used in this subsection means a basis determined under any provision of subsection (a) of this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor, or

(B) by reference to other property held at any time by the person for whom the basis is to be determined.

Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, then the adjustments provided in paragraph (1) of this subsection shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. A similar rule shall be applied in the case of a series of substituted bases.

ART. 113 (b)-1. *Adjusted basis: General rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, is the cost of such property or, in the case of such property as is described in paragraphs (1) to (18), inclusive, of section 113 (a), the basis therein provided, adjusted to the extent provided in section 113 (b).

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. In the case of mines and oil or gas wells the following shall not be considered as items properly chargeable to capital account: (1) Expenditures made in the taxable year 1932 or subsequent taxable years which are allowable under article 235 or article 236 of Regulations 77, article 23 (m)-15 or 23 (m)-16 of Regulations 86, article 23 (m)-15 or 23 (m)-16 of Regulations 94, and article 23 (m)-15 or 23 (m)-16 of these regulations as deductions in computing net income; (2) expenditures made in taxable years prior to 1932 which were allowed, or which may hereafter be allowed, as deductions in computing the net income of the taxpayer for such taxable years. In the case of unimproved and unproductive real property, carrying charges, such as taxes and interest, which have not been taken as deductions by the taxpayer in determining net income for the taxable year, or a prior taxable year, are properly chargeable to capital account.

Example: A, who makes his returns on the calendar year basis, purchased property in 1929 for $10,000. He subsequently expended $6,000 for improvements. Disregarding, for the purpose of this example, the adjustments required for depreciation, the adjusted basis of the property is $16,000. If A sells the property in 1938 for $20,000, the amount of his gain will be $4,000. As to the amount of such gain to be taken into account in computing net income, see section 117.

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1938 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of

his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted. For example, the case of Corporation A discloses the following facts as of January 1, 1938:

Year	Allowed	Allowable	Allowed, but not less than amount allowable
1931	$6,000	$5,000	$6,000
1932	7,000	6,500	7,000
1933	6,500	6,500	6,500
1934	6,500	6,000	6,500
1935	5,000	6,000	6,000
1936	4,500	6,000	6,000
1937	4,000	6,000	6,000
	39,500	42,000	44,000

The depreciation allowed but not less than the amount allowable in this example as of January 1, 1938, is $44,000, and the cost or other basis of the property is to be adjusted by that amount. The deductions by which the cost or other basis is to be decreased shall include deductions allowed under section 114 (b) (2), (3), and (4) of the Revenue Act of 1932, the Revenue Act of 1934, the Revenue Act of 1936, and the Revenue Act of 1938, for the taxable year 1932 and subsequent taxable years, but the amount of the diminution in respect of depletion for taxable years prior to 1932 shall not exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to discovery value or a percentage of income in the case of oil and gas wells.

The cost or other basis shall also be decreased by the exhaustion, wear and tear, obsolescence, amortization, and depletion sustained in respect of any period prior to March 1, 1913.

In the case of stock, the cost or other basis must be diminished by the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or 1921).

Example: A, who makes his returns upon the calendar year basis, purchased stock in 1923 for $5,000. He received in 1924 a distribution of $2,000 paid out of earnings and profits of the corporation accumulated prior to March 1, 1913. The adjusted basis for determining the gain or loss from the sale or other disposition of the stock in 1938 is $5,000 less $2,000, or $3,000, and the amount of the gain or loss from the sale or other disposition of the stock is the difference between $3,000 and the amount realized from the sale or other disposition. But see section 117.

In the case of the stock of United States shareholders in a foreign personal holding company the cost or other basis must be adjusted also to the extent provided in section 337 (f).

Adjustments must always be made to eliminate double deductions or their equivalent. Thus, in the case of the stock of a subsidiary company, the basis thereof must be properly adjusted for the amount of the subsidiary company's losses for the years in which consolidated returns were made.

In determining basis, and adjustments to basis, the principles of estoppel apply, as elsewhere under the Act.

ART. 113 (b)-2. *Adjusted basis: Cancellation of indebtedness.*—In addition to the adjustments provided in section 113 (b) (1) and article 113 (b)-1 which are required to be made with respect to the cost or other basis of property, a further adjustment shall be made in any case in which there shall have been a cancellation or reduction of indebtedness in any proceeding under section 12, 74 (except in the case of a "wage earner" as defined in the Bankruptcy Act, as amended), or 77B or under Chapter X, XI, or XII of the Bankruptcy Act of 1898, as amended. (See page 665 of the Appendix to these regulations.) Such further adjustment shall be made in the following manner and order:

(1) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable), whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this article) by the amount by which the indebtedness so incurred with respect to such property shall have been canceled or reduced;

(2) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this article) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(3) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under (1) and (2) shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by (1) and (2)) as follows: The cost or other basis of each unit of property shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this article) in an amount equal to such proportion of such excess as the adjusted basis (without reference to this article) of each such unit of property bears to the sum of the adjusted bases (without reference to this article) of all the property of the debtor other than inventory and notes and accounts receivable; and

(4) Any excess of the total amount by which such indebtedness shall have been so canceled or reduced over the sum of the adjustments made under (1), (2), and (3) shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but the amount of the decrease shall not be more than the amount of the adjusted basis without reference to this article) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable.

For the purposes of this article—

(A) Basis shall be determined as of the date of confirmation of the plan, composition or arrangement under which such indebtedness shall have been canceled or reduced;

(B) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(C) No adjustment shall be made by virtue of the cancelation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return; and

(D) The phrase "indebtedness incurred to purchase" includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay.

The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this article.

ART. 113 (b)-3. *Substituted basis.*—Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (2), the adjustments indicated

in article 113 (b)–1 shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. In addition, whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 113 (b) (2) (A), the adjustment indicated in article 113 (b)–2 shall also be made, whenever necessary, after first making in respect of such substituted basis a proper adjustment of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Similar rules shall also be applied in the case of a series of substituted bases.

Example: A, who makes his returns upon the calendar year basis, in 1926 purchased the X Building and subsequently gave it to his son B. B exchanged the X Building for the Y Building in a tax-free exchange, and then gave the Y Building to his wife C. C, in determining the gain from the sale or other disposition of the Y Building in 1938, is required to reduce the basis of the building by deductions for depreciation which were successively allowed (but not less than the amount allowable) to A and B upon the X Building and to B upon the Y Building, in addition to the deductions for depreciation allowed (but not less than the amount allowable) to herself during her ownership of the Y Building.

CHAPTER XIV

Depreciation and Depletion

SEC. 114. *Basis for depreciation and depletion.*—(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for depletion.*—(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) *Discovery value in case of mines.*—In the case of mines (other than metal, coal, or sulphur mines) discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance under section 23 (m) based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section. The above right of election shall be subject to the qualification that this paragraph shall, for the purpose of determining whether the method of computing the depletion allowance follows the property, be considered a continuation of section 114 (b) (4) of the Revenue Act of 1934 and the Revenue Act of 1936, and as giving no new election in cases where either of such sections would, if applied, give no new election.

ART. 114–1. *Basis for allowance of depreciation and depletion.*—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in article 23 (m)–3, relating to depletion based on discovery value, in article 23 (m)–4, relating to percentage depletion in the case of oil and gas wells, and in article 23 (m)–5, relating to percentage depletion in the case of coal mines, metal mines, and sulphur mines or deposits.

CHAPTER XV

Distributions by Corporations—Dividends

SEC. 115. *Distributions by corporations.*—(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years, if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning before January 1, 1938. In the case of amounts distributed (whether before January 1, 1938, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 331 (a) (2)) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a short-term capital gain—

(1) Unless such liquidation is completed before July 1 1938; or

(2) Unless (if it is established to the satisfaction of the Commissioner by evidence submitted before July 1, 1938, that due to the laws of the foreign country in which such corporation is incorporated, or for other reason, it is or will be impossible to complete

the liquidation of such company before such date) the liquidation is completed on or before such date as the Commissioner may find reasonable, but not later than December 31, 1938.

(*d*) *Other distributions from capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(*e*) *Distributions by personal service corporations.*—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(*f*) *Stock dividends.*—(1) *General rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of shareholders as to medium of payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

(*g*) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(*h*) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(*i*) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(*j*) *Valuation of dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

(*k*) *Consent distributions.*—For taxability as dividends of amounts agreed to be included in gross income by shareholders' consents, see section 28.

ART. 115–1. *Dividends.*—The term "dividend" for the purpose of Title I (except when used in sections 203 (a) (3) and 207 (c) (1) thereof) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either—

(1) earnings or profits accumulated since February 28, 1913, or

(2) earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

The application of section 115 (a) may be illustrated by the following example:

Example: At the beginning of the calendar year 1938, the M Corporation had an operating deficit of $200,000 and the earnings or profits for the year amounted to $100,000. Beginning on March 16, 1938, the corporation made quarterly distributions during the taxable year to its shareholders of $25,000 each. Each distribution is a taxable dividend in full, irrespective of the actual or the pro rata amount of the earnings or profits on hand at any of the dates of distribution, since the total distributions made during the year ($100,000) did not exceed the total earnings or profits of the year ($100,000).

ART. 115–2. *Sources of distributions in general.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits. In determining the source of a distribution, consideration should be given *first*, to the earnings or profits of the taxable year; *second*, to the earnings or profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings or profits of that year; *third*, to the earnings or profits accumulated prior to March 1, 1913, only after all the earnings or profits of the taxable year and all the earnings or profits accumulated since February 28, 1913, have been distributed; and, *fourth*, to sources other than earnings or profits only after the earnings or profits have been distributed.

If the earnings or profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings or profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend. (See article 115–1.) If the distributions made during the taxable year exceed the earnings or profits of such year, then that proportion of each distribution which the total of the earnings or profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year. The portion of each such distribution which is not regarded as out of earnings or profits of the taxable year shall be considered a taxable dividend to the extent of the earnings or profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings or profits accumulated since February 28, 1913, and the actual earnings or profits to the date of a distribution within any taxable year (whether beginning before January 1, 1938, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made. The provisions of this article may be illustrated by the following example:

Example: At the beginning of the calendar year 1938, the M Corporation had $12,000 in earnings and profits accumulated since February 28, 1913. Its earnings and profits for 1938 amounted to $30,000. During the year it made quarterly distributions of $15,000 each. Of each of the four distributions made, $7,500 (that portion of $15,000 which the amount of $30,000, the total earnings and profits of the taxable year, bears to $60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, $7,500

and $4,500, respectively, were paid out of the earnings and profits accumulated after February 28, 1913, and prior to the taxable year, as follows:

Distributions during 1938		Portion out of earnings or profits of the taxable year	Portion out of earnings accumulated since Feb. 28, 1913, and prior to taxable year	Taxable amount of each distribution
Date	Amount			
Mar. 10	$15,000	$7,500	$7,500	$15,000
June 10	15,000	7,500	4,500	12,000
Sept. 10	15,000	7,500		7,500
Dec. 10	15,000	7,500		7,500
Total amount taxable as dividends				42,000

Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Title I.

ART. 115-3. *Earnings or profits.*—In determining the amount of earnings or profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated prior to March 1, 1913) due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive. Among the items entering into the computation of corporate earnings or profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 22 (a) of the Act or corresponding provisions of prior Acts. Gains and losses within the purview of section 112 or corresponding provisions of prior Acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section. Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

In the case of a corporation in which depletion is a factor in the determination of income, the only depletion deductions to be considered in the computation of earnings or profits are those based on (1) cost or other basis, if the depletable asset was acquired subsequent to February 28, 1913, or (2) adjusted cost or March 1, 1913, value, whichever is higher, if acquired prior to March 1, 1913. Thus, discovery and percentage depletion under all Revenue Acts for mines and oil and gas wells should not be taken into consideration in computing the earnings or profits of a corporation.

A loss sustained for a year prior to the taxable year does not affect the earnings or profits of the taxable year. However, in determining the earnings or profits accumulated since February 28, 1913, the excess of a loss sustained for a year subsequent to February 28, 1913, over the undistributed earnings or profits accumulated since February 28, 1913, and prior to the year for which the loss was sustained, reduces surplus as of March 1, 1913, to the extent of such excess. And, if the surplus as of March 1, 1913, was sufficient to absorb such excess, distributions to shareholders after the year of the loss are out of earnings or profits accumulated since the year of the loss to the extent of such earnings.

With respect to the effect on the earnings or profits accumulated since February 28, 1913, of distributions made on or after January 1, 1916, and prior to August 6, 1917, out of earnings or profits accumulated prior to March 1, 1913, which distributions were specifically declared to be out of earnings or profits accumulated prior to March 1, 1913, see section 31 (b) of the Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917.

ART. 115-4. *Distributions other than a dividend.*—Under section 115 (d), any distribution (including a distribution out of earnings or profits accumulated before March 1, 1913) other than

(1) a dividend (see articles 115-1 and 115-2),

(2) a distribution out of increase in value of property accrued prior to March 1, 1913 (see article III-1), or

(3) a distribution in partial or complete liquidation (see article 115-5)

shall be applied against and reduce the adjusted basis of the stock provided in section 113 and shall be taxable to the recipient if, and to the extent that, such distribution exceeds such basis. The provisions of this article are applicable to such distributions received by one corporation from another corporation.

Example: In 1938 the M Corporation purchased certain shares of stock in the O Corporation for $10,000. During that year the M Corporation received a distribution from the O Corporation of $2,000 paid out of earnings or profits of the O Corporation accumulated prior to March 1, 1913. This distribution must be applied by the M Corporation against the basis of its stock in the O Corporation reducing such basis to $8,000. The $2,000 does not constitute a part of the earnings or profits of the M Corporation. If the M Corporation subsequently sells the stock of the O Corporation for $9,000, it realizes a gain of $1,000, which constitutes a part of its earnings or profits for the year in which the stock is sold. If the distribution had amounted to $14,000, the gain of $4,000 would be taxable to the M Corporation and would have constituted a part of the earnings or profits of that corporation for the year in which the distribution was made.

ART. 115-5. *Distributions in liquidation—(a) General.*—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and article 111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112.

(b) Complete liquidation.—In the case of amounts distributed in complete liquidation of a corporation, the amount of the gain or loss so recognized is subject in general to the limitations contained in section 117. For this purpose the term "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning prior to January 1, 1938.

For the purposes of the last sentence of section 115 (c), a liquidation may be completed prior to the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible).

For the purpose of this article the determination of whether a foreign corporation was a foreign personal holding company with respect to a taxable year beginning on or before, and ending after August 26, 1937, shall be made under section 331 of the Revenue Act of 1936, added to such Act by section 201 of the Revenue Act of 1937, and articles 331-1, 331-2, and 331-3 of Chapter XXXIV, added to Regulations 94 by Treasury Decision 4782, approved December 7, 1937 (C. B. 1937-2, p. 168).

Example: A, an individual whose taxable year is the calendar year, owns 20 shares of stock of the N Corporation, a domestic corporation, 10 shares of which were acquired in 1924 at a cost of $1,250 and the balance of 10 shares in June.

1936, at a cost of $3,000. He receives in May, 1938, a distribution of $200 per share in complete liquidation, or $2,000 on the 10 shares acquired in 1924, and $2,000 on the 10 shares acquired in June, 1936. The gain of $750 on the shares acquired in 1924 should be included in A's gross income to the extent of 50 percent, or $375; the loss of $1,000 on the shares acquired in 1936 should be deducted in computing A's net income to the extent of 66⅔ percent, or $666.67. (See section 117 (b). See also section 117 (c).)

(c) *Partial liquidation.*—In the case of amounts distributed in partial liquidation of a corporation, the amount of the loss recognized is subject to the limitations contained in section 117 but the entire amount of the gain recognized shall be considered as a short-term capital gain despite the provisions of section 117. The term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not pro rata among the shareholders.

In the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining taxability of subsequent distributions by the corporation. (See articles 27 (g)–1 and 115–11.)

Example: A, an individual whose taxable year is the calendar year, owns 20 shares of participating preferred stock of the Y Corporation, 10 shares of which he purchased in 1924 for $1,060 and 10 shares of which he purchased in June, 1936, at $2,000. On May 15, 1938, the corporation in a transaction qualifying as a partial liquidation redeemed the entire issue of preferred stock by paying the holders thereof $141 per share. A receiving $2,820 upon the surrender of his 20 shares of such stock. The gain of $350 on the shares acquired in 1924 should be included in its entirety in A's gross income; but the loss of $590 on the shares acquired in 1936 should be deducted in computing A's net income to the extent of 66⅔ percent, or $393.33. (See section 117 (b). See also section 117 (c).)

ART. 115–6. *Distributions from depletion or depreciation reserves.*—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property as provided in article 111–1. A distribution from a depletion reserve based upon discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when received by the shareholders, taxable as an ordinary dividend. The amount by which a corporation's percentage depletion allowance for any year exceeds depletion sustained on cost or other basis, that is, determined without regard to discovery or percentage depletion allowances for the year of distribution or prior years, constitutes a part of the corporation's "earnings or profits accumulated after February 28, 1913," within the meaning of section 115, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. (See article 111–1.) No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed.

ART. 115–7. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution.[1] The distinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

Example (1): The X Corporation had an authorized capital stock of $300,000 of common stock, par value $10 a share, and $100,000 of 7 percent cumulative preferred stock, par value $100 a share, which is preferred as to dividends, has no voting rights, and may be redeemed at any time at $105 per share. The articles of incorporation provide that the annual dividend on the preferred stock may be paid in cash or, at the option of the corporation, in one share of common stock for each share of preferred. On July 1, 1938, the X Corporation had outstanding $200,000 of common stock and $100,000 of preferred stock, earnings and profits of $60,000 accumulated since February 28, 1913, and earnings and profits of the taxable year amounting to $15,000. On July 1, 1938, it distributed 1,000 shares of its common stock of an aggregate par value (and fair market value) of $10,000 to the holders of its preferred stock in payment of the annual dividend on such stock. The stock so distributed constitutes a taxable stock dividend to the holders of the preferred stock.

Example (2): On July 1, 1938, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1938, the Y Corporation issued and divided among its shareholders 250 additional shares of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

Example (3): The Z Corporation had an authorized capital stock of 30,000 shares of common, without par value, and 10,000 shares of 7 percent cumula-

[1] See *Eisner* v. *Macomber* (252 U. S., 189, T. D. 3010, C. B. 3, 25 (1920)); and *Koshland* v. *Helvering* (298 U. S., 441, Ct. D. 1124, C. B. VX–1, 219 (1936)). Compare *United States* v. *Phellis* (257 U. S., 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S., 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S., 134, T. D. 3508, C. B. II–2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S., 242, T. D. 2609, C. B. III–2, 51 (1924)); and *Marr* v. *United States* (268 U. S., 536, T. D. 3755, C. B. IV–2, 116 (1925)).

tive preferred stock, par $100, which is preferred as to dividends, has voting rights and may be redeemed on the 1st of January or July of any year by the payment of $105 per share and accrued dividends. On July 1, 1938, the company's issued and outstanding stock amounted to 20,000 shares of common and 6,000 shares of preferred, and it had $250,000 earnings and profits accumulated since February 28, 1913, and $90,000 earnings and profits of the taxable year. On July 1, 1938, it paid a dividend on its common stock in preferred stock at the rate of $\frac{1}{10}$ share of preferred on each share of common outstanding. The preferred stock so distributed constitutes a taxable stock dividend to the holders of common stock.

ART. 115–8. *Election of shareholders as to medium of payment.*—If the shareholder has the right to an election or option with respect to whether a distribution shall be paid either (*a*) in money or any other property or (*b*) in stock or rights to acquire stock of a class which, if distributed without an election, would not constitute income within the meaning of the sixteenth amendment to the Constitution, then the entire distribution is a taxable dividend regardless of—

(1) whether the distribution is actually made, in whole or in part, in stock or in stock rights which, if distributed without election, would not constitute a taxable dividend;

(2) whether the election is exercised or exercisable before or after the declaration of the distribution; or

(3) whether the declaration of the dividend provides that payment will be made in one medium unless the shareholder specifically requests payment in the other.

The term "any other property" as used in this article includes stock of the corporation or rights to acquire its stock, of a class which if distributed without an election, would constitute income within the meaning of the sixteenth amendment to the Constitution. (See article 115–7.)

ART. 115–9. *Distribution in redemption or cancellation of stock taxable as a dividend.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

ART. 115–10. *Dividends paid in property.*—If the whole or any part of the dividend is paid to a shareholder in any medium other than money, the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder. (See article 42–3.) Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 115–11. *Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.*—If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and intercompany transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.

The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

(1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization—

(A) in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or

(B) in any taxable year (beginning before January 1, 1938, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) The distribution in any taxable year (beginning before January 1, 1938, or on or after such date) of stock or securities, or other property or money, to a corporation in complete liquidation of another corporation, under the circumstances described in section 112 (b) (6) of the Revenue Act of 1936 or section 112 (b) (6) of the Revenue Act of 1938.

(3) The distribution in any taxable year (beginning after December 31, 1937) of stock or securities, or other property or money, in the case of an exchange or distribution described in section 371 (relating to exchanges and distributions in obedience to orders of the Securities and Exchange Commission), if no gain to the distributees from the receipt of such stock, securities, or other property or money was recognized by law.

(4) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraph (1), (2), (3), or (4) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. In the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in paragraph (1), (2), or (3) above) the earnings or profits of the corporation making the distribution are diminished by the portion of such distribution properly chargeable to earnings or profits accumulated after February 28, 1913, after first deducting from the amount of such distribution the portion thereof allocable to capital account.

For the purposes of this article, the terms "reorganization" and "party to the

reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932; for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934; and for any taxable year beginning after December 31, 1935, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1936.

CHAPTER XVI

Additional Exclusions From Gross Income

SEC. 116. *Exclusions from gross income.*—In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this title:

(a) *Earned income from sources without United States.*—In the case of an individual citizen of the United States, a bona fide nonresident of the United States for more than six months during the taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts would constitute earned income as defined in section 25 (a) if received from sources within the United States; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) *Teachers in Alaska and Hawaii.*—In the case of an individual employed by Alaska or Hawaii or any political subdivision thereof as a teacher in any educational institution, the compensation received as such. This subsection shall not exempt compensation paid directly or indirectly by the Government of the United States.

(c) *Income of foreign governments.*—The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States.

(d) *Income of States, municipalities, etc.*—Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—

(1) If by the terms of such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax upon the net income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title.

(e) *Bridges to be acquired by State or political subdivision.*—Whenever any State or political subdivision thereof, in pursuance of a contract to which it is not a party entered into before the enactment of the Revenue Act of 1928, is to acquire a bridge—

(1) If by the terms of such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such bridge prior to any division of such proceeds, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision, then a tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State or political subdivision (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision, bears to the amount of the net income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title.

(f) *Dividend from "China Trade Act" corporation.*—In the case of a persons, amounts distributed as dividends to or for his benefit by a corporation organized under the China Trade Act, 1922, if, at the time of such distribution, he is a resident of China, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him.

(g) *Shipowners' protection and indemnity associations.*—The receipts of shipowners' mutual protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax upon their net income from interest, dividends, and rents.

(h) *Compensation of employees of foreign governments.*—(1) *Rule for exclusion.*—Wages, fees, or salary of an employee of a foreign government (including a consular or other officer, or a nondiplomatic representative) received as compensation for official services to such government—

(A) If such employee is not a citizen of the United States; and

(B) If the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and

(C) If the foreign government whose employee is claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

(2) *Certificate by Secretary of State.*—The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries.

ART. 116–1. *Income of foreign governments, ambassadors, and consuls.*—The exemption of the income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States in stocks, bonds, or other domestic securities, which are not actually owned by but are loaned to such foreign governments, is subject to tax.

Ambassadors and ministers accredited to the United States and the members of their households (including secretaries, attachés, and servants) who are not citizens of the United States, are exempt from the payment of Federal income tax upon their salaries, fees, or wages. Their income from all sources other than a business carried on by them in the United States is also exempt. These provisions are also applicable to the wives and minor children of foreign ambassadors and ministers and the members of their households, including secretaries, attachés, and servants.

All employees of a foreign government (including consular or other officers, or nondiplomatic representatives) who are not citizens of the United States are exempt from Federal income tax with respect to wages, fees, or salaries received by them as compensation for official services rendered in the United States to such foreign government, provided (1) the services are of a character similar to those performed by employees of the Government of the United States in such foreign country and (2) the foreign government whose employees are claiming exemption grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country. Section 116 (h) (2) provides that the Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries. The income received by employees of foreign

governments (other than ambassadors, ministers and members of their households including secretaries, attachés and servants) from sources other than their salaries, fees, or wages, referred to above, is subject to Federal income tax. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax. (But see section 116 (a).) Under the provisions of the tax convention between the United States and France, and without regard to any other provision of this article, compensation paid by France to French citizens for labor or personal services performed in the United States is exempt from Federal income tax. (See page 680 of the Appendix to these regulations.)

ART. 116–2. *Compensation of State officers and employees.*—Compensation received for services rendered to a State is to be included in gross income unless the person receives such compensation from the State as an officer or employee thereof and such compensation is immune from taxation under the Constitution of the United States.

One is not an officer or employee of a State merely by reason of rendering services to the State and receiving compensation therefor. Persons employed by a State, under a contract for the rendering of services of a special nature, such as those performed by a consulting engineer who is employed to advise a State with respect to water supply or sewage disposal systems, whose duties are prescribed by the contract and whose work is not of a permanent or continuous character, are not officers or employees of the State.

If all or part of the compensation of an officer or employee of a State is paid directly or indirectly by the United States, such compensation (or part) is taxable, as, for example, any compensation paid by the United States to officers of the National Guard of a State, or compensation paid by a State to officers or employees of an agricultural school or college wholly or partly out of grants from the United States.

The commissions of receivers appointed by the State courts and the fees received by notaries public are taxable. As used in this article, the term "State" includes a political subdivision of a State.

ART. 116–3. *Bridges to be acquired by State or political subdivisions.*—(1) Any State or political subdivision thereof claiming a refund under the provisions of section 116 (e) of an amount equal to all or a portion of any income tax levied, assessed, collected, and paid in the manner and at the rates prescribed in Title I, shall file a claim therefor on Form 843 (to which there shall be attached as exhibits the matter hereinafter prescribed) with the collector of internal revenue for the district in which the tax was paid, which claim shall be executed on behalf of such State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain—

(*a*) A statement of the name of the taxpayer, of the amount of tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought;

(*b*) A full statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (e);

(*c*) A showing which will establish to the satisfaction of the Commissioner that the fiscal officer presenting the claim has authority to receive the amount of the refund on behalf of the State or political subdivision which he assumes to represent and to apply without delay the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments considered by the claimant sufficient to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund; and

(*d*) An affidavit made by or on behalf of the taxpayer, which affidavit shall state that the taxpayer thereby joins with and concurs in the request of the State or political subdivision thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, that the taxpayer agrees to receive the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States upon its demand the entire amount of the refund with interest at 6 percent per annum from the date the refund is made without seeking or claiming the benefit of any statute of limitations which prior thereto may have run against the United States.

(2) No refund shall be made of any amount in excess of the amount of the tax levied, assessed, collected, and paid by the taxpayer for any taxable year or period. A separate claim shall be made in respect of each separate taxable year or period. If by the terms of the contract on which the claim is based two or more States or political subdivisions of a State or States are entitled to acquire the bridge, the claim for refund in respect of each separate taxable year or period must be made jointly by the States or political subdivisions thereof so entitled. The amount refunded under section 116 (e) and this article is not considered an overpayment within the meaning of section 614 of the Revenue Act of 1928 (paragraph 42 of the Appendix to these regulations), relating to interest on overpayments, and no interest shall be allowed or paid upon the amount of the refund.

(3) A check or voucher in payment of a claim for refund allowed under section 116 (e) will be drawn in the name of the fiscal officer or officers having authority, as established under paragraph (1) (*c*) hereof, to receive the same, and will contain an express provision that it is issued for the sole purpose and subject to the conditions prescribed in that section and this article.

CHAPTER XVII

Capital Gains and Losses

SEC. 117. *Capital gains and losses.*—(*a*) *Definitions.*—As used in this title—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l);

(2) *Short-term capital gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-term capital loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-term capital loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net short-term capital gain.*—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the sum of (A) short-term capital losses for the taxable year, plus (B) the net short-term capital loss of the preceding taxable year, to the extent brought forward to the taxable year under subsection (e);

(7) *Net short-term capital loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) *Net long-term capital gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net long-term capital loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(*b*) *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or ex-

change of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;
66⅔ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;
50 per centum if the capital asset has been held for more than 24 months.

(c) *Alternative taxes.*—(1) *In case of net long-term capital gain.*—If for any taxable year a taxpayer (other than a corporation) derives a net long-term capital gain, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 30 per centum of the net long-term capital gain.

(2) *In case of net long-term capital loss.*—If for any taxable year a taxpayer (other than a corporation) sustains a net long-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is greater than the tax imposed by such sections:

A partial tax shall first be computed upon the net income increased by the amount of the net long-term capital loss, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax minus 30 per centum of the net long-term capital loss.

(d) *Limitation on capital losses.*—(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States (including laws relating to the District of Columbia) or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

(2) *Other taxpayers.*—In the case of a taxpayer other than a corporation, short-term capital losses shall be allowed only to the extent of short-term capital gains.

(e) *Net short-term capital loss carry-over.*—If any taxpayer (other than a corporation) sustains in any taxable year a net short-term capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a short-term capital loss, except that it shall not be included in computing the net short-term capital loss for such year.

(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

(g) *Gains and losses from short sales, etc.*—For the purpose of this title—

(1) gains or losses from short sales of property shall be considered as gains or losses from sales or exchanges of capital assets; and

(2) gains or losses attributable to the failure to exercise privileges or options to buy or sell property shall be considered as short-term capital gains or losses.

(h) *Determination of period for which held.*—For the purpose of this section—

(1) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under the provisions of section 112 (g) of the Revenue Act of 1928 or the Revenue Act of 1932, or under the provisions of section 371 (c) of this Act, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(4) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the non-deductibility (under section 118 of this Act or section 118 of the Revenue Act of 1928 or the Revenue Act of 1932 or the Revenue Act of 1934 or the Revenue Act of 1936, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

ART. 117–1. *Meaning of terms.*—The term "capital assets" includes all classes of property not specifically excluded by section 117 (a) (1). In determining whether property is a "capital asset," the period for which held is immaterial.

The exclusion from the term "capital assets" of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23 (l) is limited to property used by the taxpayer in the trade or business at the time of the sale or exchange. It has no application to gains or losses arising from the sale of real property used in the trade or business to the extent that such gain or loss is allocable to the land, as distinguished from depreciable improvements upon the land. To such gain or loss allocable to the land the limitations of sections 117 (b), (c), and (d) apply (such limitation may be inapplicable to a dealer in real estate, but, if so, it is because he holds the land primarily for sale to customers in the ordinary course of his trade or business, not because land is subject to a depreciation allowance). Gains or losses from the sale or exchange of property used in the trade or business of the taxpayer of a character which is subject to the allowance for depreciation provided in section 23 (l), will not be subject to the percentage provisions of section 117 (b) and losses from such transactions will not be subject to the limitations on losses provided in section 117 (d). The term "ordinary net income" as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

Section 117 (a) (2) to (9), inclusive, defines "short-term capital gain," "short-term capital loss," "long-term capital gain," long-term capital loss," "net short-term capital gain," "net short-term capital loss," "net long-term capital gain," and "net long-term capital loss." These terms are used in the subsequent subsections of section 117. The phrase "short-term" applies to the category of gains and losses arising from the sale or exchange of capital assets held for 18 months or less; the phrase "long-term" to the category of gains and losses arising from the sale or exchange of capital assets held for more than 18 months. The fact that some part of a short-term capital loss may be finally disallowed because of the operation of section 117 (d) (2) does not mean that such loss is not "taken into account in computing net income" within the meaning of that phrase as used in section 117 (a) (3).

In the definition of "net short-term capital gain," as provided in section 117 (a) (6), reference is made in clause (B) thereof, to the net short-term capital loss of the preceding taxable year to the extent brought forward to the taxable year under subsection (e). The amount so provided for is the net short-term capital loss carry-over, which is treated in the taxable year in question as a short-term capital loss. In this computation, the carry-over enters into the computation of the net short-term capital gain only in clause (B). The amount thereof is not to be included under clause (A) of section 117 (a) (6). Thus, for the purposes of clause (A), the short-term capital losses for the taxable year are computed without reference to, or including, the amount provided for in subsection (e). For example, during the taxable year 1939 an individual has a short-term capital gain of $10,000 and a short-term capital loss in that year of $4,000. During the taxable year 1938 he sustained a net short-term capital loss of $2,500 which was not in excess of his net income for that year. His net short-term capital gain for the taxable year 1939 is computed as follows:

1939 short-term capital gain		$10,000
Less:		
1939 short-term capital loss to be allowed under section 117 (a) (6) (A)	$4,000	
Net short-term capital loss of proceeding taxable year to extent brought forward under section 117 (e) and allowed under section 117 (a) (6) (B)	2,500	
		6,500
Net short-term capital gain for 1939		3,500

In the case of individuals, gains and losses from the sale or exchange of capital assets held for not more than 18 months (described as short-term capital gains and short-term capital losses) shall be segregated from gains and losses arising from the sale or exchange of such assets held for more than 18 months (described as long-term capital gains and long-term capital losses). This segregation is applicable only to the capital gains and capital losses of individuals and does not apply to corporations, since the percentage brackets of section 117 (b) have no application to corporations, corporate gains and losses being taken into account to the full extent, without regard to the length of time the capital assets are held (though because of the limitation in section 117 (d) such losses may not be deductible in full).

See section 23 (g) and (k), under which losses from worthless stocks, bonds, and other securities (if they constitute capital assets) are required to be treated as losses under section 117 from the sale or exchange of capital assets, even though such securities are not actually sold or exchanged.

ART. 117–2. *Percentage of capital gain or loss taken into account: Net loss carry-over.*—In computing the net income of a taxpayer, other than a corporation, the amount of the gain or loss, computed under section 111 and recognized under section 112, upon the sale or exchange of a capital asset shall be taken into account only to the extent provided in section 117 (b). The percentage of the gain or loss to be taken into account ranges from 100 percent to 50 percent, depending upon the period for which the asset was held. For instance, if unimproved real estate purchased by an individual for $20,000 is a capital asset and is sold by him for $25,000 after having been held for more than two years, only 50 percent of the recognized gain ($5,000), or $2,500, shall be taken into account in computing net income; or if such property is sold for $14,000, only 50 percent of the recognized loss ($6,000), or $3,000, shall be so taken into account.

Section 117 (d) (1) provides a limitation on deductions for capital losses affecting corporations, that is, losses from sales or exchanges of capital assets shall be allowed as deductions only to the extent of $2,000 plus the gains from such sales or exchanges. However, in the case of certain banks or trust companies, this limitation is subject to the modification provided in that section. Section 117 (d) (2) provides a further limitation on deductions for short-term capital losses of taxpayers other than corporations, that is, losses from sales or exchanges of capital assets held for 18 months or less shall be allowed as deductions only to the extent of the gains from sales or exchanges of capital assets held for 18 months or less. However, subsection (e) of section 117 provides that a taxpayer (other than a corporation) having in any taxable year (beginning after December 31, 1937) a net short-term capital loss, may carry over such loss, in an amount not in excess of his net income for such year (the year in which the loss is realized), to the next succeeding taxable year and treat it in such succeeding year as a short-term capital loss. The carry-over is thus applied in such succeeding year to offset any short-term capital gains in such succeeding year not already offset by short-term capital losses in such year. The carry-over is restricted to one year, namely, the succeeding taxable year, and hence the amount of the net short-term capital loss carry-over may not be included in computing a new net short-term capital loss which can be carried over to the second succeeding taxable year.

The practical operation of the provisions of this article may be illustrated by the following examples:

Example (1): During the taxable year 1938, A, an individual, has ordinary net income (net income exclusive of gains or losses from sales or exchanges of capital assets) of $6,000 and gains and losses resulting from sales or exchanges of capital assets as follows:

Short-Term Capital Gains and Losses

Asset	Gain	Loss	Holding period	Percentage under section 117 (b)	Amount taken into account	
					Gain	Loss
			Months			
Corporation stock		$10,000	18	100		$10,000
Corporation bonds	$4,000		12	100	$4,000	
Government bonds	3,000		10	100	3,000	
Short-term capital loss taken into account						10,000
Short-term capital gain taken into account					7,000	
Net short-term capital loss						3,000

Long-Term Capital Gains and Losses

Asset	Gain	Loss	Holding period	Percentage under section 117 (b)	Amount taken into account	
					Gain	Loss
			Months			
Corporation stock		$12,000	19	66⅔		$8,000
Corporation bonds		6,000	40	50		3,000
Government bonds	$1,000		25	50	$500	
Real estate	9,000		23	66⅔	6,000	
Long-term capital loss taken into account						11,000
Long-term capital gain taken into account					6,500	
Net long-term capital loss						4,500

Computation of Net Income

Ordinary net income		$6,000
Short-term capital gains		7,000
Long-term capital gains		6,500
Total		19,500
Deduct:		
Short-term capital loss (to extent of short-term capital gains)	$7,000	
Long-term capital loss	11,000	
		18,000
Net income		1,500

Example (2): For the taxable year 1939 the same individual as in Example (1) has ordinary net income (net income other than gains or losses from sales or exchanges of capital assets) of $6,000; short-term capital gains of $5,500; and short-term capital losses of $5,000. His long-term capital gains and losses *to be taken into account* in computing net income consist of the following: Long-term capital gains, $7,000; long-term capital losses, $6,000. His net income is computed as follows:

Ordinary net income		$6,000
Short-term capital gains		5,500
Long-term capital gains		7,000
Total		18,500
Deduct:		
Short-term capital loss:		
(1) Realized during taxable year (subject to section 117 (d) (2)	$5,000	
(2) Net short-term capital loss carry-over (not in excess of net income for 1938, $1,500), but not to exceed excess of short-term capital gains over short-term capital losses for 1939	500	
Long-term capital loss	6,000	
		11,500
Net income		7,000
Net short-term capital loss carry-over to 1940		None

ART. 117–3. *Alternative tax in case of net long-term capital gain or loss.*—In the case of a net long-term capital gain of a taxpayer other than a corporation, subsection (c) (1) of section 117 imposes an alternative tax in lieu of the tax imposed by sections 11 and 12, if and only if such alternative tax is less than the tax imposed by sections 11 and 12. This alternative tax is the sum of (1) a partial tax, computed at the rates provided by sections 11 and 12, on the net income of the taxpayer, excluding therefrom for

this purpose the amount of such net long-term capital gain, plus (2) 30 percent of the net long-term capital gain.

In the case of a net long-term capital loss of a taxpayer other than a corporation, an alternative tax is imposed in lieu of the tax imposed by sections 11 and 12, if and only if such tax is greater than the tax imposed by sections 11 and 12. This alternative tax is the excess of (1) a tax, at the rates provided by sections 11 and 12, on the net income of the taxpayer, but excluding from the computation of such net income, the amount of the net long-term capital loss over (2) 30 percent of the net long-term capital loss.

The following examples will illustrate the practical operation of the provisions of this article:

Example (1): Suppose that A, an individual, has for the calendar year 1938 an ordinary net income of $100,000, none of which consists of interest on the obligations of the United States or its instrumentalities. He is entitled to a personal exemption of $2,500 and to no credit for dependents, and his earned net income is $3,000. He realizes in that year a gain of $45,000 on a capital asset held for 19 months and a gain of $40,000 on a capital asset held for 26 months. Suppose, also, that A has no losses from the sale or exchange of capital assets. Since the alternative tax is less than the tax otherwise computed under sections 11 and 12, the correct tax is the alternative tax, that is, $47,513. The tax is computed as follows:

Tax Under Sections 11 and 12

Ordinary net income		$100,000
Capital gains:		
66⅔ percent of $45,000	$30,000	
50 percent of $40,000	20,000	
		50,000
Total net income		150,000
Less credit for personal exemption		2,500
Surtax net income		147,500
Less earned income credit (10 percent of $3,000)		300
Income subject to normal tax		147,200
Normal tax (4 percent of $147,200)		5,888
Surtax on $147,500		57,550
Total tax		63,438

Alternative Tax Under Section 117 (c) (1)

Net income		$150,000
Less net long-term capital gain		50,000
Ordinary net income		100,000
Less credit for personal exemption		2,500
Surtax net income		97,500
Less earned income credit (10 percent of $3,000)		300
Income subject to normal tax		97,200
Normal tax (4 percent of $97,200)		3,888
Surtax on $97,500		28,625
Partial tax under sections 11 and 12 on $100,000		32,513
Plus 30 percent of $50,000		15,000
Total alternative tax		47,513

Example (2): Suppose that in example (1) the facts with respect to net income and credits are the same, except that the taxpayer has for the calendar year 1938 an ordinary net income of $200,000, and that he realizes in that year a loss of $100,000 on a capital asset held for 5 years, and that he has no gains from the sale or exchange of capital assets. Since the alternative tax is greater than the tax otherwise computed under sections 11 and 12, the correct tax is the alternative tax, that is, $80,388. The tax is computed as follows:

Tax Under Sections 11 and 12

Ordinary net income		$200,000
Less net long-term capital loss (50 percent of $100,000)		50,000
Net income subject to tax		150,000
Less credit for personal exemption		2,500
Surtax net income		147,500
Less earned income credit (10 percent of $3,000)		300
Net income subject to normal tax		147,200
Normal tax (4 percent of $147,200)		5,888
Surtax on $147,500		57,550
Total tax		63,438

Alternative Tax Under Section 117 (c) (2)

Net income (excluding from the computation $50,000, the amount of the net long-term capital loss)		$200,000
Less credit for personal exemption		2,500
Surtax net income		197,500
Less earned income credit (10 percent of $3,000)		300
Income subject to normal tax		197,200
Normal tax (4 percent of $197,200)		7,888
Surtax on $197,500		87,500
Partial tax under sections 11 and 12 on $200,000		95,388
Less 30 percent of $50,000		15,000
Alternative tax		80,388

ART. 117–4. *Determination of period for which capital assets are held.*—Under section 117 (h) if property is acquired in certain transactions described in sections 112, 113, 118, and 371 (c), the period for which such property is considered to have been held by the taxpayer is not computed from the date such property was acquired by the taxpayer but from a prior date. For instance: In the case of stock or securities in a corporation a party to a reorganization received pursuant to a plan of reorganization in exchange solely for stock or securities in another corporation a party to the reorganization, the period for which the stock or securities exchanged were held by the taxpayer must be included in the period for which the stock or securities received on the exchange were held by the taxpayer. In the case of property acquired after December 31, 1920, by gift (if under the provisions of section 113, such property has, for the purpose of determining gain or loss from the sale or exchange, the same basis in the hands of the taxpayer as it would have in the hands of the donor), the period for which the property was held by the donor must be included in the period for which the property was held by the taxpayer. In the case of stock or securities the acquisition of which resulted in the nondeductibility (under section 118, Revenue Act of 1928, 1932, 1934, 1936, or 1938) of the loss from the sale or other disposition of substantially identical stock or securities, the period for which the stock or securities the loss from the sale or other disposition of which was not deductible were held must be included in the period for which the stock or securities acquired were held by the taxpayer.

The period for which the taxpayer has held stock issued to him as a nontaxable stock dividend shall be determined as though the stock dividend were the stock in respect of which the dividend was issued.

ART. 117–5. *Application of section 117 in the case of husband and wife—(a) Short-term capital gains and losses.*—Under the general rule with respect to taking deductions in a joint return of husband and wife (see article 51–1), a deduction which is not allowable in computing the net income of one spouse making a separate return is not allowable in a joint return made by both spouses. Hence, the limitation under section 117 (d) (2), relating to the allowance of short-term capital losses, is, in the case of one spouse, to be computed without regard to the short-term capital gains and losses of the other spouse, regardless of whether a joint return or separate returns are filed.

(b) Long-term capital gains and losses.—In the case of a joint return, the tax under sections 11 and 12 is imposed upon the aggregate net income of both spouses, after giving effect to the deductions to which each spouse would be entitled in a separate return (see article 51–1). The allowance of a long-term capital loss is not subject to a limitation such as that contained in section 117 (d) (2). Accordingly, in the case of a joint return, the long-term capital losses of either spouse may be deducted from the aggregate income in computing the tax imposed under sections 11 and 12. The alternative taxes computed under section 117 (c) are in lieu of the tax imposed by sections 11 and 12 and must be compared with the tax imposed by such sections to determine which tax is applicable. Therefore, in computing the alternative taxes under section 117 (c) in the case of a joint return, the determination of the "net long-term capital gain" or the "net long-term capital loss" is to be made by first aggregating the long-term capital gains, and the long-term capital losses, respectively, of both spouses.

ART. 117–6. *Gains and losses from short sales.*—For income tax purposes, a short sale is not deemed to be consum-

mated until delivery of property to cover the short sale, and the percentage of the recognized gain or loss to be taken into account under section 117 (b) from a short sale shall be computed according to the period for which the property so delivered was held. Thus, if a taxpayer made a short sale of shares of stock and covered the short sale by purchasing and delivering shares which he held for not more than 18 months, 100 percent of the recognized gain or loss would be taken into account under section 117 (b), even though he had on hand other shares of the same stock which he held for more than 18 months. If, however, he covered the short sale by delivering shares which he held for more than 18 months but not for more than 24 months, only 66⅔ percent of the recognized gain or loss would be taken into account. If the short sale is made through a broker and the broker borrows property to make delivery, the short sale is not deemed to be consummated until the obligation of the seller created by the short sale is finally discharged by delivery of property to the broker to replace the property borrowed by the broker.

CHAPTER XVIII

Loss From Wash Sales

SEC. 118. *Loss from wash sales of stock or securities.*—(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

(b) If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(c) If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 118–1. *Losses from wash sales of stock or securities.*—(a) A taxpayer cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date (referred to in this article as the 61-day period), he has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities. However, this prohibition does not apply (1) in the case of a taxpayer, not a corporation, if the sale or other disposition of stock or securities is made in connection with the taxpayer's trade or business, or (2) in the case of a corporation, a dealer in stock or securities, if the sale or other disposition of stock or securities is made in the ordinary course of its business as such dealer. See article 22 (a)–8 as to stock or securities sold from lots purchased at different dates or at different prices where the identity of the lots cannot be determined and article 113 (a) (10)–1 for the basis for determining gain or loss from the subsequent sale or other disposition of stock or securities acquired in connection with wash sales.

(b) Where more than one loss is claimed to have been sustained within the taxable year from the sale or other disposition of stock or securities, the provisions of this article shall be applied to the losses in the order in which the stock or securities the disposition of which resulted in the respective losses were disposed of (beginning with the earliest disposition). If the order of disposition of stock or securities disposed of at a loss on the same day cannot be determined, the stock or securities will be considered to have been disposed of in the order in which they were originally acquired (beginning with the earliest acquisition).

(c) Where the amount of stock or securities acquired within the 61-day period is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be those with which the stock or securities acquired are matched in accordance with the following rule:

The stock or securities acquired will be matched in accordance with the order of their acquisition (beginning with the earliest acquisition) with an equal number of the shares of stock or securities sold or otherwise disposed of.

(d) Where the amount of stock or securities acquired within the 61-day period is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which resulted in the nondeductibility of the loss shall be those with which the stock or securities disposed of are matched in accordance with the following rule:

The stock or securities sold or otherwise disposed of will be matched with an equal number of the shares of stock or securities acquired in accordance with the order of acquisition (beginning with the earliest acquisition) of the stock or securities acquired.

(e) The acquisition of any share of stock or any security which results in the nondeductibility of a loss under the provisions of this article shall be disregarded in determining the deductibility of any other loss.

(f) The word "acquired" as used in this article means acquired by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law, and comprehends cases where the taxpayer has entered into a contract or option within the 61-day period to acquire by purchase or by such an exchange.

Example (1): A, whose taxable year is the calendar year, on December 1, 1937, purchased 100 shares of common stock in the M Company for $10,000 and on December 15, 1937, purchased 100 additional shares for $9,000. On January 2, 1938, he sold the 100 shares purchased on December 1, 1937, for $9,000. Because of the provisions of section 118 no loss from the sale is allowable as a deduction.

Example (2): A, whose taxable year is the calendar year, on September 21, 1937, purchased 100 shares of the common stock of the M Company for $5,000. On December 21, 1937, he purchased 50 shares of substantially identical stock for $2,750, and on December 26, 1937, he purchased 25 additional shares of such stock for $1,125. On January 2, 1938, he sold for $4,000 the 100 shares purchased on September 21, 1937. There is an indicated loss of $1,000 on the sale of the 100 shares. Since within the 61-day period A purchased 75 shares of substantially identical stock, the loss on the sale of 75 of the shares ($3,750–$3,000, or $750) is not allowable as a deduction because of the provisions of section 118. The loss on the sale of the remaining 25 shares ($1,250–$1,000, or $250) is deductible subject to the limitations provided in sections 24 (b) and 117. The basis of the 50 shares purchased December 21, 1937, the acquisition of which resulted in the nondeductibility of the loss ($500) sustained on 50 of the 100 shares sold on January 2, 1938, is $2,500 (the cost of 50 of the shares sold on January 2, 1938), plus $750 (the difference between the purchase price of the 50 shares acquired on December 21, 1937 ($2,750) and the selling price of 50 of the shares sold on January 2, 1938 ($2,000)), or $3,250. Similarly the basis of the 25 shares purchased on December 26, 1937, the acquisition of which resulted in the nondeductibility of the loss ($250) sustained on 25 of the shares sold on January 2, 1938, is $1,250 plus $125, or $1,375. (See article 113 (a) (10)–1.)

Example (3): A, whose taxable year is the calendar year, on September 15, 1936, purchased 100 shares of the stock of the M Company for $5,000. He sold these shares on February 1, 1938, for $4,000.

On each of the four days from February 15, 1938, to February 18, 1938, he purchased 50 shares of substantially identical stock for $2,000. There is an indicated loss of $1,000 from the sale of the 100 shares on February 1, 1938, but, since within the 61-day period A purchased not less than 100 shares of substantially identical stock, the loss is not deductible. The particular shares of stock the purchase of which resulted in the nondeductibility of the loss are the first 100 shares purchased within such period, that is, the 50 shares purchased on February 15, 1938, and the 50 shares purchased on February 16, 1938. In determining the period for which the 50 shares purchased on February 15, 1938, and the 50 shares purchased on February 16, 1938, were held, there is to be included the period for which the 100 shares purchased on September 15, 1936, and sold on February 1, 1938, were held.

CHAPTER XIX

Income From Sources Within United States

SEC. 119. *Income from sources within United States.*—(a) *Gross income from sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:

(1) *Interest.*—Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein, or

(B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable, or

(C) income derived by a foreign central bank of issue from bankers' acceptances;

(2) *Dividends.*—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for the purposes of section 131 (relating to foreign tax credit), be treated as income from sources without the United States;

(3) *Personal services.*—Compensation for labor or personal services performed in the United States, but in the case of a non-resident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year, compensation received by such an individual (if such compensation does not exceed $3,000 in the aggregate) for labor or services performed as an employee of or under a contract with a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, shall not be deemed to be income from sources within the United States;

(4) *Rentals and royalties.*—Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) *Sale of real property.*—Gains, profits, and income from the sale of real property located in the United States.

(6) *Sale of personal property.*—For gains, profits, and income from the sale of personal property, see subsection (e).

(b) *Net income from sources in United States.*—From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

(c) *Gross income from sources without United States.*—The following items of gross income shall be treated as income from sources without the United States:

(1) Interest other than that derived from sources within the United States as provided in subsection (a) (1) of this section;

(2) Dividends other than those derived from sources within the United States as provided in subsection (a) (2) of this section;

(3) Compensation for labor or personal services performed without the United States;

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties; and

(5) Gains, profits, and income from the sale of real property located without the United States.

(d) *Net income from sources without United States.*—From the items of gross income specified in subsection (c) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

(e) *Income from sources partly within and partly without United States.*—Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section, shall be allocated or apportioned to sources within or without the United States, under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits, and income from—

(1) transportation or other services rendered partly within and partly without the United States, or

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States,

shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits, and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold, except that gains, profits, and income derived from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States.

(f) *Definitions.*—As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word "produced" includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged".

ART. 119–1. *Income from sources within the United States.*—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251 are taxable only upon income from sources within the United States. Citizens of the United States and domestic corporations entitled to the benefits of section 251 are, however, taxable upon income received within the United States, whether derived from sources within or without the United States. (See sections 212 (a), 231 (c), and 251.)

The Act divides the income of such taxpayers into three classes:

(1) Income which is derived in full from sources within the United States;

(2) Income which is derived in full from sources without the United States; and

(3) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allo-

cated or apportioned to sources within the United States.

ART. 119–2. *Interest.*—There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations which are entitled to the benefits of section 251, all interest received or accrued, as the case may be, from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:

(*a*) Interest paid on deposits with persons, including individuals, partnerships, or corporations, carrying on the banking business, to persons (nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251) not engaged in business within the United States, and not having an office or place of business therein;

(*b*) Interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 percent of the gross income of such resident payor or domestic corporation has been derived from sources within the United States (as determined under the provisions of section 119) for the 3-year period ending with the close of the taxable year of the payor which precedes the payment of such interest, or for such part of that period as may be applicable; and

(*c*) Income derived by a foreign central bank of issue from bankers' acceptances. A foreign central bank of issue means a bank which is by law or government sanction the principal authority (other than the government itself) issuing instruments intended to circulate as currency. Such banks are generally the custodians of the banking reserves of their countries.

Any taxpayer who excludes from gross income from sources within the United States income of the type specified in paragraph (*a*), (*b*), or (*c*) shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified in those paragraphs.

Interest received from the United States by a foreign corporation or a nonresident alien on a refund of Federal income taxes is taxable as income from sources within the United States.

As to the inclusion in gross income of items received in the United States even though representing income from sources without the United States, in the case of citizens of the United States and domestic corporations entitled to the benefits of section 251, see article 251–2.

ART. 119–3. *Dividends.*—Gross income from sources within the United States includes dividends, as defined by section 115:

(*a*) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corporation less than 20 percent of the gross income of which is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 119, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

(*b*) From a foreign corporation unless less than 50 percent of its gross income for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends, or for such part of such period as it has been in existence, was derived from sources within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the United States bears to its gross income from all sources. However, for the purposes of section 131, relating to credits for taxes of foreign countries and possessions of the United States, dividends from a foreign corporation shall be treated as income from sources without the United States.

Dividends will be treated as income from sources within the United States (except for the purposes of section 131) unless the taxpayer submits sufficient data to establish to the satisfaction of the Commissioner that they should be excluded from gross income under (*a*) or (*b*) of this article. (See also section 116 (f).)

ART. 119–4. *Compensation for labor or personal services.*—Except as provided in section 119 (a) (3), gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for service was made, or of the place of payment. If a specific amount is paid for labor or personal services performed in the United States, such amount (if income from sources within the United States) shall be included in the gross income. If no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. Except as provided in section 119 (a) (3), wages received for services rendered inside the territorial limits of the United States and wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States.

ART. 119–5. *Rentals and royalties.*—Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, including rentals or royalties for the use of or the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. The income arising from the rental of property, whether tangible or intangible, located within the United States, or from the use of property, whether tangible or intangible, within the United States, is from sources within the United States.

ART. 119–6. *Sale of real property.*—Gross income from sources within the United States includes gain, computed under the provisions of sections 111–113, derived from the sale or other disposition of real property located in the United States. For the treatment of capital gains and losses, see section 117.

ART. 119–7. *Income from sources without the United States.*—Gross income from sources without the United States includes:

(1) Interest other than that specified in section 119 (a) (1), as being derived from sources within the United States;

(2) Dividends other than those derived from sources within the United States as provided in section 119 (a) (2);

(3) Compensation for labor or personal services performed without the United States (for the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States, see article 119–4);

(4) Rentals or royalties derived from property without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property (see article 119–5); and

(5) Gain derived from the sale of real property located without the United States (see sections 111–113).

ART. 119–8. *Sale of personal property.*—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, except that income derived from the purchase of personal property within a possession of the United States

and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States. A possession of the United States constitutes a "country," within the meaning of this article, separate and distinct from the United States. Hence income derived from the purchase of personal property within the United States and its sale within a possession of the United States shall be treated as derived entirely from within a possession of the United States. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See article 119–12.)

ART. 119–9. *Deductions in general.*—The deductions provided for in Title I shall be allowed to nonresident alien individuals and foreign corporations engaged in trade or business within the United States or having an office or place of business therein, and to citizens of the United States and domestic corporations entitled to the benefits of section 251, only if and to the extent provided in sections 213, 215, 232, 233, and 251.

ART. 119–10. *Apportionment of deductions.*—From the items specified in articles 119–1 to 119–6 as being derived specifically from sources within the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example: A nonresident alient individual (engaged in trade or business within the United States or having an office or place of business therein) whose taxable year is the calendar year, derived gross income from all sources for 1938 of $180,000, including therein:

Interest on bonds of a domestic corporation	$9,000
Dividends on stock of a domestic corporation	4,000
Royalty for the use of patents within the United States	12,000
Gain from sale of real property located within the United States	11,000
Total	36,000

that is, one-fifth of the total gross income was from sources within the United States. The remainder of the gross income was from sources without the United States, determined under article 119–7.

The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $8,000 is properly allocated to income from sources within the United States and the amount of $40,000 is properly allocated to income from sources without the United States.

The remainder of the expenses, $30,000, cannot be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the United States to the total gross income, shall be deducted in computing net income from sources within the United States. Thus, there are deducted from the $36,000 of gross income from sources within the United States expenses amounting to $14,000 (representing $8,000 properly apportioned to the income from sources within the United States and $6,000, a ratable part (one-fifth) of the expenses which could not be allocated to any item or class of gross income). The remainder, $22,000, is the net income from sources within the United States.

ART. 119–11. *Other income from sources within the United States.*—Items of gross income other than those specified in section 119 (a) and (c) shall be allocated or apportioned to sources within or without the United States, as provided in section 119 (e).

The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from the sale by the producer of the products thereof within or without the United States, shall ordinarily be included in gross income from sources within the United States. If, however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in article 119–12.

Where items of gross income are separately allocated to sources within the United States, there shall be deducted therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income.

ART. 119–12. *Income from the sale of personal property derived from sources partly within and partly without the United States.*—Items of gross income not allocated by articles 119–1 to 119–8 or 119–11 to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States. Such income derived from the sale of personal property may be divided into two classes: (A) income derived from sources partly within the United States and partly within a foreign country, and (B) income derived from sources partly within the United States and partly within a possession of the United States.

A. The portion of such income derived from sources partly within the United States and partly within a foreign country which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country, or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a foreign country under one of the cases named below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1–A.—Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country from that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department, at the independent factory price so established. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2–A.—Where an independent factory or production price has not been established as provided under case 1–A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accord-

ance with the value of the taxpayer's property within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the foreign country. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within the United States and within the foreign country. The "gross sales of the taxpayer within the United States" means the gross sales made during the taxable year which were principally secured, negotiated, or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the United States. The term "gross sales" as used in this paragraph refers only to the sales of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, and the term "property" includes only the property held or used to produce income which is derived from such sales. Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of taxation shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case 3–A.—Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas herein prescribed, the income derived from sources within the United States.

B. The portion of such income derived from sources partly within the United States and partly within a possession of the United States which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the cases named below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1–B.—Same as case 1–A.

Case 2–B.—Where an independent factory or production price has not been established as provided under case 1–A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the possession of the United States. The remaining one-half of such net income shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the amount of the taxpayer's business for the taxable year or period within the United States, and the denominator of which consists of the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees and for the purchase of goods, materials, and supplies consumed in the regular course of business, plus the amounts received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the production (in whole or in part) of personal property within the United States and its sale within a possession of the United States or to the production (in whole or in part) of personal property within a possession of the United States and its sale within the United States. The term "property" as used in this paragraph includes only the property held or used to produce income which is derived from such sales.

Case 3–B.—Same as case 3–A.

Personal property purchased and sold.—Gross income derived from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the following cases:

Case 1–B.—The net income shall first be computed by deducting from such gross income the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The amount of net income so determined shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being that percentage of such net income which the amount of the taxpayer's business for the taxable year or period within the United States bears to the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees

and for the purchase of goods, materials, and supplies sold or consumed in the regular course of business, plus the amount received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the purchase of personal property within a possession of the United States and its sale within the United States.

Case II–B.—Same as case 3–A.

ART. 119–13. *Transportation service.*—A foreign corporation carrying on the business of transportation, service between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(1) The gross income from sources within the United States derived from such services shall be determined by taking such a portion of the total gross revenues therefrom as (*a*) the sum of the costs or expenses of such transportation business carried on by the taxpayer within the United States and a reasonable return upon the property used in its transportation business while within the United States bears to (*b*) the sum of the total costs or expenses of such transportation business carried on by the taxpayer and a reasonable return upon the total property used in such transportation business. Revenues from operations incidental to transportation services (such as the sale of money orders) shall be apportioned on the same basis as direct revenues from transportation services.

In allocating the total costs or expenses incurred in such transportation business, costs or expenses incurred in connection with that part of the services which was wholly rendered in the United States should be assigned to the cost of transportation business within the United States. For example, expenses of loading and unloading in the United States, rentals, office expenses, salaries, and wages wholly incurred for services rendered to the taxpayer in the United States belong to this class. Costs and expenses incurred in connection with services rendered partly within and partly without the United States may be prorated on a reasonable basis between such services. For example, ship wages, charter money, insurance, and supplies chargeable to voyage expenses should ordinarily be prorated for each voyage on the basis of the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days on the voyage, and fuel consumed on each voyage may be prorated on the basis of the proportion which the number of miles sailed within the territorial limits of the United States bears to the total number of miles sailed on the voyage. Income, war-profits, and excess-profits taxes should not be regarded as costs or expenses for the purpose of determining the proportion of gross income from sources within the United States; and for such purpose, interest and other expenses for the use of borrowed capital should not be taken into the cost of services rendered, for the reason that the return upon the property used measures the extent to which such borrowed capital is the source of the income. For other expenses entering into the cost of services, only such expenses as are allowable deductions under the Revenue Act of 1938 should be taken.

The value of the property used should be determined upon the basis of cost less depreciation. Eight percent may ordinarily be taken as a reasonable rate of return to apply to such property. The property taken should be the average property employed in the transportation service between points in the United States and points outside the United States during the taxable year. Current assets should be decreased by current liabilities and allocated to services between the United States and foreign countries and to other services. The part allocated to services between the United States and foreign countries should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services. The amount so allocated to services between the United States and foreign countries should be further allocated to services rendered within the United States and to services rendered without the United States. The portion allocable to services rendered within the United States should be based on the proportion which the expenses incurred within the territorial limits of the United States bear to the total expenses incurred in services between the United States and foreign countries. For ships the average should be determined upon a daily basis for each ship and the amount to be apportioned for each ship as assets employed within the United States should be computed upon the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such year either for the assets employed in the transportation business in the United States or in total, the average must be determined upon a monthly or daily basis.

(2) In computing net income from sources within the United States there shall be allowed as deductions from the gross income as determined in accordance with paragraph (1), (*a*) the expenses of the transportation business carried on within the United States as determined under paragraph (1), and (*b*) the expenses determined in accordance with paragraphs (3) and (4).

(3) Interest and income, war-profits, and excess-profits taxes should be excluded from the apportionment process, as explained in paragraph (1); but for the purpose of computing net income there may be deducted from the gross income from sources within the United States, after the amount of such gross income has been determined, a ratable part (*a*) of all interest (deductible under section 23 (b)), and (*b*) of all income, war-profits, and excess-profits taxes (deductible under section 23 (c) and (d)), paid or accrued in respect of the business of transportation service between points in the United States and points outside the United States. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income from such transportation service.

(4) If a foreign corporation subject to this article is also engaged in a business other than that of providing transportation service between points in the United States and points outside the United States, the costs and expenses (including taxes) properly apportioned or allocated to such other business should be excluded both from the deductions and from the apportionment process prescribed in paragraph (1); but, for the purpose of determining net income, a ratable part of any general expenses, losses, or deductions, which cannot definitely be allocated to some item or class of gross income, may be deducted from the gross income from sources within the United States after the amount of such gross income has been determined. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income.

(5) Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer subject to this article, who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in paragraphs (1)–(4), the income derived from sources within the United States.

ART. 119–14. *Telegraph and cable service.*—A foreign corporation carrying on the business of transmission of telegraph or cable messages between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(1) *Gross income.*—The gross income from sources within the United States derived from such services shall be deter-

mined by adding (*a*) its gross revenues derived from messages originating in the United States and (*b*) amounts collected abroad on collect messages originating in the United States and deducting from such sum amounts paid or accrued for transmission of messages beyond the company's own circuit. Amounts received by the company in the United States with respect to collect messages originating without the United States shall be excluded from gross income.

(2) *Net income.*—In computing net income from sources within the United States there shall be allowed as deductions from gross income determined in accordance with paragraph (1), (*a*) all expenses incurred in the United States (not including any general overhead expenses) incident to the carrying on of the business in the United States, (*b*) all direct expenses incurred abroad in the transmission of messages originating in the United States (not including any general overhead expenses or maintenance, repairs, and depreciation of cables and not including any amount already deducted in computing gross income), (*c*) depreciation of property (other than cables) located in the United States and used in the trade or business therein, and (*d*) a proportionate part of the general overhead expenses (not including any items incurred abroad corresponding to those enumerated in (*a*), (*b*), and (*c*)) and of maintenance, repairs, and depreciation of cables of the entire cable system of the enterprise based on the ratio which the number of words originating in the United States bears to the total words transmitted by the enterprise.

ART. 119–15. *Computation of income.*—If a taxpayer has gross income from sources within or without the United States as defined by section 119 (a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investments applicable thereto, shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

CHAPTER XX

Certain Deductions for Charitable and Other Contributions and Dividends Paid

SEC. 120. *Unlimited deduction for charitable and other contributions.*—In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (o) (or corresponding provisions of prior revenue Acts) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 15 per centum limit imposed by section 23 (o) shall not be applicable.

SEC. 121. *Deduction of dividends paid on certain preferred stock of certain corporations.*—In computing the net income of any national banking association, or of any bank or trust company organized under the laws of any State, Territory, possession of the United States, or the Canal Zone, or of any other banking corporation engaged in the business of industrial banking and under the supervision of a State banking department or of the Comptroller of the Currency, or of any incorporated domestic insurance company, there shall be allowed as a deduction from gross income, in addition to deductions otherwise provided for in this title, any dividend (not including any distribution in liquidation) paid, within the taxable year, to the United States or to any instrumentality thereof exempt from Federal income taxes, on the preferred stock of the corporation owned by the United States or such instrumentality. The amount allowable as a deduction under this section shall be deducted from the basic surtax credit otherwise computed under section 27 (b).

CHAPTER XXI

Credits Against Tax—Supplemental

Supplement C—Credits Against Tax [Supplementary to Subtitle B, Part III]

SEC. 131. *Taxes of foreign countries and possessions of United States.*—(*a*) *Allowance of credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) *Citizen and domestic corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) *Resident of United States.*—In the case of a resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) *Alien resident of United States.*—In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) *Partnerships and estates.*—In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(*b*) *Limit on credit.*—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

(*c*) *Adjustments on payment of accrued taxes.*—If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner, as a condition precedent to the allowance of this credit, may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(*d*) *Year in which credit taken.*—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(*e*) *Proof of credits.*—The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits.

(*f*) *Taxes of foreign subsidiary.*—For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the amount of tax deemed to have been paid under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(*g*) *Corporations treated as foreign.*—For the purposes of this section the following corporations shall be treated as foreign corporations:

(1) A corporation entitled to the benefits of section 251, by reason of receiving a large

percentage of its gross income from sources within a possession of the United States;

(2) A corporation organized under the China Trade Act, 1922, and entitled to the credit provided for in section 262.

ART. 131–1. *Analysis of credit for taxes.*—If the taxpayer signifies in his return his desire to claim a credit for taxes, the basis of such credit, in the case of a citizen of the United States, whether resident or nonresident, and in the case of a domestic corporation, is as follows: (*a*) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and (*b*) an individual's proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

In the case of an alien resident of the United States who signifies in his return his desire to claim a credit for such taxes the basis of the credit is as follows: (*a*) The amount of any such taxes paid or accrued during the taxable year to any possession of the United States; (*b*) the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and (*c*) his proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to any possession of the United States, or to any foreign country, as the case may be, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country.

If a taxpayer signifies in his return his desire to claim a credit for taxes, such action will be considered to apply to income, war-profits, and excess-profits taxes paid to all foreign countries and possessions of the United States, and no portion of any such taxes shall be allowed as a deduction from gross income.

A citizen of the United States or a domestic corporation entitled to the benefits of section 251, or a China Trade Act corporation, is not allowed any of the credits provided by section 131.

ART. 131–2. *Meaning of terms.*—The "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. "Foreign country" means any foreign state or political subdivision thereof, or any foreign political entity, which levies and collects income, war-profits, or excess-profits taxes. "Any possession of the United States" includes, among others, Puerto Rico, the Philippines, and the Virgin Islands. But see section 251. As to the meaning of "sources," see section 119. (See also section 901.)

ART. 131–3. *Conditions of allowance of credit.*—If the taxpayer signifies in his return his desire to claim credit for income, war-profits, or excess-profits taxes paid other than to the United States, the income tax return must be accompanied by Form 1116 in the case of an individual, and by Form 1118 in the case of a corporation. The form must be carefully filled in with all the information there called for and with the calculations of credits there indicated, and must be duly signed and sworn to or affirmed. If credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. If credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original, or a duly certified or authenticated copy. If the receipt or the return is in a foreign language, a certified translation thereof must be furnished by the taxpayer. Any additional information necessary for the determination under section 119 of the amount of income derived from sources without the United States and from each foreign country shall, upon the request of the Commissioner, be furnished by the taxpayer.

In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to Form 1116 or 1118. If such a bond is required, Form 1117 shall be used by an individual and Form 1119 by a corporation. It shall be in such sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, or the agent or representative of the taxpayer, as principal, and by sureties satisfactory to and approved by the Commissioner. (See also section 1126 of the Revenue Act of 1926, as amended, paragraph 35 of the Appendix to these regulations.)

For credit where taxes are paid by a foreign corporation controlled by a domestic corporation, see article 131–7. A claim for credit in such a case is also to be made on Form 1118. See article 131–6 with reference to the option granted by section 131 (d).

If it is the desire of the taxpayer to claim as a credit and not as a deduction accrued income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States but at the time the return is made it is impossible to estimate the amount of such taxes that may have accrued for the period for which the return is made, Form 1116 in the case of an individual, and Form 1118 in the case of a corporation, may be filed at a later date but a credit cannot be allowed for such taxes unless the taxpayer signifies in his return his desire to have to any extent the benefits of section 131.

ART. 131–4. *Redetermination of tax when credit proves incorrect.*—In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 322.

ART. 131–5. *Countries which do or do not satisfy the similar credit requirement.*—A country satisfies the similar credit requirement of section 131 (a) (3), as to income tax paid to such country, either by allowing to citizens of the United States residing in such country a credit for the amount of income taxes paid to the United States, or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such country. A country does not satisfy the similar credit requirement of section 131 (a) (3) if it does not allow any credit to citizens of the United States residing in such country for the amount of income taxes paid to the United States, or if such country does not impose any income taxes. If the country of which a resident alien is a citizen or subject does not allow to a United States citizen residing in such country a credit for taxes paid by such citizen to another foreign country, no credit is allowed to such resident alien for taxes paid by him to such other foreign country.

ART. 131–6. *When credit for taxes may be taken.*—The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in which

the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer, at his option and irrespective of the method of accounting employed in keeping his books, to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made under this section or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926, or under section 131 (d) of the Revenue Act of 1928, 1932, 1934, or 1936, must be followed in returns for all subsequent years, and no portion of any such taxes will be allowed as a deduction from gross income.

ART. 131–7. *Domestic corporation owning a majority of the stock of foreign corporation.*—In the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year, the credit for foreign taxes includes not only the income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States by such domestic corporation, but also income, war-profits, and excess-profits taxes deemed to have been paid determined by taking the same proportion of any income, war-profits, and excess-profits taxes paid or accrued by such controlled foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. The amount of taxes deemed to have been paid is limited, however, to an amount which shall in no case exceed the same proportion of the tax against which the credit for foreign taxes is taken, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. If dividends are received from more than one controlled foreign corporation, the limitation is to be computed separately for the dividends received from each controlled foreign corporation. If the credit for foreign taxes includes taxes deemed to have been paid, the taxpayer must furnish the same information with respect to the taxes deemed to have been paid as it is required to furnish with respect to the taxes actually paid or accrued by it. Taxes paid or accrued by a controlled foreign corporation are deemed to have been paid by the domestic corporation for purposes of credit only.

ART. 131–8. *Limitations on credit for foreign taxes.*—The amount of the income and profits taxes paid or accrued (including the taxes which, in accordance with the provisions of section 131 (f), are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131 (b) (1) so as not to exceed that proportion of the tax against which credit is taken which the taxpayer's net income from sources within such country or possession bears to his entire net income for the same taxable year, is the tentative credit in respect of the taxes paid or accrued to such country or possession. The sum of these tentative credits, limited under section 131 (b) (2) so as not to exceed the same proportion of the tax against which credit is taken which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year, is the amount allowable as a credit against the income tax under Title I for income or profits taxes paid or accrued to foreign countries or possessions of the United States.

The operation of the limitations on the credit for foreign taxes may be illustrated by the following examples:

Example (1): In 1938, A, a citizen of the United States, had a net income for services rendered within the United States amounting to $50,000 and a net income from sources within Great Britain of $25,000. He is entitled to a personal exemption of $1,000. The credit for foreign taxes allowable to A in his return for the calendar year 1938 is $6,494.67, computed as follows:

Income from sources within the United States	$50,000.00
Income from sources within Great Britain	25,000.00
Total net income	75,000.00
United States income tax on $75,000	19,484.00
British income and profits taxes	7,500.00
Limitation on British income and profits taxes under section 131 (b) (1) and (2) to determine credit $\left(\frac{25,000}{75,000}\text{ of }\$19,434\right)$	6,494.67
Credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitations under section 131 (b) (1) and (2))	6,494.67

Example (2): If, in example (1), above, A had a net income from sources within Great Britain of $15,000 and a net income from sources within Canada of $10,000 and the income and profits taxes paid or accrued to Great Britain and Canada were $4,000 and $1,200, respectively, the credit for foreign taxes allowable to A would be $5,096.80, computed as follows:

Income from sources within the United States	$50,000.00
Income from sources within Great Britain	15,000.00
Income from sources within Canada	10,000.00
Total net income	75,000.00
United States income tax on $75,000	19,484.00
British income and profits taxes	4,000.00
Limitation on British income and profits taxes under section 131 (b) (1) to determine tentative credit $\left(\frac{15,000}{75,000}\text{ of }\$19,484\right)$	3,896.80
Tentative credit for British income and profits taxes (total British income and profits taxes, reduced in accordance with the limitation under section 131 (b) (1))	3,896.80
Canadian income and profits taxes	1,200.00
Limitation on Canadian income and profits taxes under section 131 (b) (1) to determine tentative credit $\left(\frac{10,000}{75,000}\text{ of }\$19,484\right)$	2,597.86
Tentative credit for Canadian income and profits taxes (total Canadian income and profits taxes, since such amount is within the limitation under section 131 (b) (1))	1,200.00
Sum of tentative credits ($3,896.80 plus $1,200)	5,096.80
Limitation on sum of tentative credits under section 131 (b) (2) to determine credit $\left(\frac{25,000}{75,000}\text{ of }\$19,484\right)$	6,494.67
Total amount of credit allowable (sum of tentative credits, since such sum is within the limitation under section 131 (b) (2))	5,096.80

Example (3): The net income for the calendar year 1938 and the income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation were as follows:

Country	Net income	Loss	Income and profits taxes (paid or accrued)
United States	$200,000		
Great Britain	20,000		$7,500
Canada	20,000		1,800
Brazil	40,000		2,400
Argentine Republic	60,000		None.
Mexico		$100,000	None.
Puerto Rico	10,000		1,250
France (dividend)	50,000		[1] 9,000
France (branch)	20,000		3,000

[1] Withheld.

Entire net income	$330,000
Total foreign net income	130,000
United States tax before allowance of credit for foreign taxes	48,340

The income and losses from all foreign countries and possessions of the United States, except the dividend from sources within France, were derived from branch operations. Dividends of $50,000 were received from a French corporation, a majority of the voting stock of which was owned by the domestic corporation. The French corporation paid to France income and profits taxes on income earned by it and in addition a dividend tax for the account of its shareholders on income distributed to them, the latter tax being withheld and paid at the source.

The computation of the credit is as follows:

Great Britain

Income and profits taxes paid or accrued	$7,500.00
Limitation under section 131 (b) (1) $\left(\frac{30,000}{330,000}\right.$ of $48,340$\left.\right)$	4,394.55
Tentative credit	4,394.55

Canada

Income and profits taxes paid or accrued	$1,800.00
Limitation under section 131 (b) (1) $\left(\frac{20,000}{330,000}\right.$ of $48,340$\left.\right)$	2,929.70
Tentative credit	1,800.00

Brazil

Income and profits taxes paid or accrued	$2,400.00
Limitation under section 131 (b) (1) $\left(\frac{40,000}{330,000}\right.$ of $48,340$\left.\right)$	5,859.40
Tentative credit	2,400.00

Argentine Republic

Tentative credit	None.

Mexico

Tentative credit	None.

Puerto Rico

Income and profits taxes paid or accrued	$1,250.00
Limitation under section 131 (b) (1) $\left(\frac{10,000}{330,000}\right.$ of $48,340$\left.\right)$	1,464.85
Tentative credit	1,250.00

France

Dividend tax paid at source		$9,000.00
Income and profits taxes paid or accrued on branch operations		3,000.00
Income and profits taxes deemed under section 131 (f) to have been paid, computed as follows:		
Dividend received on December 31 of the taxable year	$50,000.00	
Income of French corporation earned during taxable year	200,000.00	
Income and profits taxes paid to France on $200,000	30,000.00	
Accumulated profits ($200,000 minus $30,000)	170,000.00	
French taxes applicable to accumulated profits distributed $\left(\frac{50,000}{170,000}\right.$ of $\left(\frac{170,000}{200,000}\right.$ of $30,000$\left.\right)\right)$	7,500.00	
Limitation under section 131 (f) $\left(\frac{50,000}{330,000}\right.$ of $48,340$\left.\right)$	7,324.24	
Income and profits taxes deemed to have been paid (French taxes applicable to accumulated profits distributed to domestic corporation, reduced in accordance with the limitation under section 131 (f))		7,324.24
Total income and profits taxes paid or accrued and deemed to have been paid to France		19,324.24
Limitation under section 131 (b) (1) $\left(\frac{70,000}{330,000}\right.$ of $48,340$\left.\right)$		10,253.94
Tentative credit		10,253.94

Sum of Tentative Credits

Great Britain	$4,394.55
Canada	1,800.00
Brazil	2,400.00
Puerto Rico	1,250.00
France	10,253.94
	20,098.49
Limitation on sum of tentative credits under section 131 (b) (2) to determine credit $\left(\frac{130,000}{330,000}\right.$ of $48,340$\left.\right)$	19,043.03
Total amount of credit allowable (sum of tentative credits reduced in accordance with the limitation under section 131 (b) (2))	19,043.03

CHAPTER XXII

Returns and Payment of Tax

Supplement D—Returns and Payment of Tax [Supplementary to Subtitle B, Part V]

SEC. 141. *Consolidated returns of railroad corporations.*—(*a*) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) (or, in case such regulations are not prescribed prior to the making of the return, then the regulations prescribed under section 141 (b) of the Revenue Act of 1936 insofar as not inconsistent with this Act) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(*b*) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(*c*) *Computation and payment of tax.*—In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b), (or, in case such regulations are not prescribed prior to the making of the return, then the regulations prescribed under section 141 (b) of the Revenue Act of 1936 insofar as not inconsistent with this Act) prescribed prior to the date on which such return is made.

(*d*) *Definition of "affiliated group".*—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations; and

(3) Each of the corporations is either (A) a corporation whose principal business is that of a common carrier by railroad or (B) a corporation the assets of which consist principally of stock in such corporations and which does not itself operate a business other than that of a common carrier by railroad. For the purpose of determining whether the principal business of a corporation is that of a common carrier by railroad, if a common carrier by railroad has leased its railroad properties and such properties are operated as such by another common carrier by railroad, the business of receiving rents for such railroad properties shall be considered as the business of a common carrier by railroad. As used in this paragraph, the term "railroad" includes a street, suburban, or interurban electric railway, or a street or suburban trackless trolley system of transportation, or a street or suburban bus system of transportation operated as part of a street or suburban electric railway or trackless trolley system.

As used in this subsection (except in paragraph (3)) the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(*e*) *Foreign corporations.*—A foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(*f*) *China Trade Act Corporations.*—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(*g*) *Corporations deriving income from possessions of United States.*—For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(*h*) *Subsidiary formed to comply with foreign law.*—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this title as a domestic corporation.

(*i*) *Suspension of running of statute of limitations.*—If a notice under section 272 (a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such

corporation made a consolidated return for such taxable year.

(*j*) *Receivership cases.*—If the common parent corporation of an affiliated group making a consolidated return would, if filing a separate return, be entitled to the benefits of section 13 (e), the affiliated group shall be entitled to the benefits of such subsection. In all other cases the affiliated group making a consolidated return shall not be entitled to the benefits of such subsection, regardless of the fact that one or more of the corporations in the group are in bankruptcy or in receivership.

(*k*) *Allocation of income and deductions.*—For allocation of income and deductions of related trades or businesses, see section 45.

ART. 141–1. *Consolidated returns of affiliated corporations for taxable years beginning after December 31, 1937.*—The regulations prescribed under section 141 (b) have been promulgated as Regulations 102 and are applicable to the making, after the promulgation of such regulations, of consolidated returns by affiliated corporations for taxable years beginning after December 31, 1937, and to the determination, computation, assessment, collection, and adjustment of tax liabilities under consolidated returns for such years. For definition of taxable year, see section 48.

ART. 141–2. *Formation of and changes in affiliated group.*—An affiliated group of corporations, within the meaning of section 141, is formed at the time that the common parent corporation becomes the owner directly of at least 95 percent of the stock (as defined by section 141 (d)) of another corporation. A corporation becomes a member of an affiliated group at the time that one or more members of the group become the owners directly of at least 95 percent of its stock. A corporation ceases to be a member of an affiliated group at the time that the aggregate of its stock owned directly by the members of the group becomes less than 95 percent.

ART. 141–3. *Corporation to be included in consolidated returns for taxable years beginning after December 31, 1937.*—The privilege of filing consolidated returns for taxable years beginning after December 31, 1937, is limited to corporations constituting an "affiliated group" as defined in section 141 (d). The Act requires each corporation to be either (1) a corporation whose principal business is that of a "common carrier by railroad" or (2) a corporation whose assets consist principally of stock in such corporations and which does not itself operate a business other than that of a "common carrier by railroad." The term "common carrier by railroad" includes steam and electric railroads, street, suburban, and interurban electric railways, street and suburban trackless trolley systems of transportation, and street or suburban bus systems of transportation operated as a part of street or suburban electric railway or trackless trolley systems, but does not include express, refrigerator, or sleeping car companies. If a "common carrier by railroad" as above defined has leased its railroad properties and such properties are operated as such by another common carrier by railroad, the business of receiving rents for such properties is considered as the business of a common carrier by railroad.

A consolidated return must include every domestic corporation which is a member of the "affiliated group"; but shall not include a foreign corporation (except as provided in section 141 (h); a corporation organized under the China Trade Act, 1922; or a corporation entitled to the benefits of section 251.

ART. 141–4. *Foreign corporations which may be treated as domestic corporations.*—In the case of a domestic corporation owning or controlling, directly or indirectly, the entire capital stock (exclusive of directors' qualifying shares) of a corporation described in section 141 (d) (3) and organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for taxable years beginning after December 31, 1937, as a domestic corporation. The option to treat such foreign corporation as a domestic corporation must be exercised at the time of making the first consolidated return under the Act, and cannot be exercised at any time thereafter. If the election is exercised to treat such foreign corporation as a domestic corporation it must be included in the consolidated return of the affiliated group of which it is a member for each year for which such group makes or is required to make a consolidated return.

SEC. 142. *Fiduciary returns.*—(*a*) *Requirement of return.*—Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income;

(4) Every estate the net income of which for the taxable year is $1,000 or over;

(5) Every trust the net income of which for the taxable year is $100 or over;

(6) Every estate or trust the gross income of which for the taxable year is $5,000 or over, regardless of the amount of the net income; and

(7) Every estate or trust of which any beneficiary is a nonresident alien.

(*b*) *Joint fiduciaries.*—Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be sufficient compliance with the above requirement. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(*c*) *Law applicable to fiduciaries.*—Any fiduciary required to make a return under this title shall be subject to all the provisions of law which apply to individuals.

ART. 142–1. *Fiduciary returns.*—Every fiduciary, or at least one of joint fiduciaries, must make a return of income—

(*a*) For the individual whose income is in his charge, if the gross income of such individual is $5,000 or over, or if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife for any part of the taxable year; or if such individual is married and was living with husband or wife for any part of the taxable year but not at the close of the taxable year and his gross income for the taxable year is $5,000 or over, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as head of a family); or if such individual is married and was living with husband or wife for the entire taxable year and the aggregate gross income of both husband and wife is $5,000 or over, or the aggregate net income of both husband and wife is $2,500 or over; or if such individual is married and was living with husband or wife at the close of the taxable year but not during the entire taxable year and the aggregate gross income of both husband and wife is $5,000 or over, or the aggregate net income of both husband and wife is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as head of a family, or

(*b*) For the estate for which he acts if the net income of such estate is $1,000 or over, as computed under section 162, and for the trust for which he acts if the net income of such trust is $100 or over, as computed under section 162, or if the gross income of the estate or trust is $5,000 or over, regardless of the amount of the net income, or if any beneficiary of such estate or trust is a nonresident alien.

The return in case (*a*) shall be on Form 1040 or 1040 A. In case (*b*) a return is required on Form 1041. A copy of the will or trust instrument sworn to by the fiduciary as a true and complete copy in cases in which the gross income of the estate or trust is $5,000 or over, must be filed with the fiduciary return of the estate or trust, together with a statement by the fiduciary indicating the provisions of the will or trust instrument which, in his opinion, determine the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively. If, however, a copy of the will

or trust instrument, or statement relating to the provisions of the will or trust instrument, has once been filed, it need not again be filed if the fiduciary return contains a statement showing when and where it was filed. If the trust instrument is amended in any way after such copy has been filed, a copy of the amendment, together with a statement by the fiduciary, indicating the effect, if any, in his opinion, of such amendment on the extent to which the income of the estate or trust is taxable to the estate or trust, the beneficiaries, or the grantor, respectively, must be filed with the return for the taxable year in which the amendment was made. See article 142–5 for returns in cases where any beneficiary is a nonresident alien. If the net income of a decedent from the beginning of the taxable year to the date of his death was equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as head of a family), or if his gross income for the same period was $5,000 or over, the executor or administrator shall make a return for such decedent. (See article 25–7.)

For information returns required to be made by fiduciaries under section 147, see article 147–1.

As to further duties and liabilities, of fiduciaries, see section 312.

ART. 142–2. *Return by guardian or committee.*—A fiduciary acting as the guardian of a minor, or as the guardian or committee of an insane person, having a net income equal to, or in excess of, the credit allowed such person by section 25 (b) (1) and (3) (computed without regard to the status of the minor or insane person as head of a family), or having a gross income of $5,000 or over, must make a return for such person on Form 1040 or 1040 A and pay the tax, unless in the case of a minor the minor himself makes a return or causes it to be made.

For the purpose of determining the liability of a fiduciary to render a return under the provisions of the preceding paragraph in cases where the minor or the incompetent is married and was living with husband or wife at the close of the taxable year, it is the aggregate gross income or the aggregate net income of both husband and wife which is controlling. (See article 51–1.)

ART. 142–3. *Returns where two trusts.*—In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and for which the same trustee acts, the trustee shall make a single return on Form 1041 for all such trusts, notwithstanding that they may arise from different instruments. If, however, one person acts as trustee for trusts created by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041 for each trust separately.

ART. 142–4. *Return by receiver.*—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on Form 1040 or 1040A. When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. (See section 52.) A receiver in charge of the business of a partnership shall render a return on Form 1065. A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual or corporation must make returns. (See also sections 147 and 148 (a).)

ART. 142–5. *Return for nonresident alien beneficiary.*—(a) *United States business or office.*—If a citizen or resident fiduciary has the distribution of the income of an estate or trust any beneficiary of which is a nonresident alien engaged in trade or business within the United States or having an office or place of business therein at any time within the taxable year, the fiduciary shall make a return on Form 1040B for such nonresident alien and pay any tax shown thereon to be due. (See sections 143 and 211.) Unless such return is a true and accurate return of the nonresident alien beneficiary's income from all sources within the United States, the benefits of the credits and deductions to which the beneficiary is entitled cannot be obtained in the return filed by the fiduciary. (See sections 215 and 251.) If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing Form 1040B in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust is a nonresident alien engaged in trade or business within the United States or having an office or place of business therein at any time within the taxable year the fiduciary shall make a return on Form 1041, as well as on Form 1040B. If there are two or more such nonresident alien beneficiaries, the fiduciary shall render a return on Form 1041 and also a return on Form 1040B for each nonresident alien beneficiary. (See further article 217–1.)

(b) *No United States business or office.*—A citizen or resident fiduciary having the distribution of the income of an estate or trust will not be required to make a return for any beneficiary of the estate or trust who is a nonresident alien not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year if the entire amount of the tax on the income payable to such beneficiary has been withheld at the source (see sections 143 and 211 (a)). A citizen or resident fiduciary having the distribution of the income of an estate or trust shall make a return on Form 1040 NB–a if a beneficiary, other than a resident of Canada, has gross income for the taxable year of more than $21,600 from the sources specified in section 211 (a), regardless of the amount of tax withheld at the source. If the gross income from such sources is $21,600 or less, the return (if a return is required to be filed) for the beneficiary shall be on Form 1040 NB. If a return is required to be filed for a beneficiary who is a resident of Canada, such return also shall be on Form 1040 NB. If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing a return in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. The fiduciary shall make a return on Form 1042 of the tax at 10 percent on the entire amount of the income payable to the beneficiary, except that in the case of a beneficiary, resident of Canada, the rate shall be 5 percent. In addition to such return or returns, the fiduciary shall make a return on Form 1041 for the estate or trust, irrespective of the number of beneficiaries.

ART. 142–6. *Time for filing return upon death, or termination of trust.*—After his appointment and qualification, an executor or administrator may immediately file a return for the decedent without waiting for the close of the taxable year. Upon the completion of the administration of an estate and final accounting, an executor or administrator may immediately file a return of income of the estate for the taxable year in which the administration was closed. Similarly, upon the termination of a trust, the trustee may immediately make a return without waiting for the close of the taxable year. Any income return required to be filed for a decedent covering the taxable year during which the decedent dies, or for the year in which an estate is closed or a trust terminated, is due on the 15th day of the third month following the close of the taxable year during which the decedent dies, the estate is closed, or the trust is terminated, which date shall also be the due date for payment of the tax or the first installment thereof if payment is made under the provisions of section 56 (b). The payment of the tax before the end of the taxable year under such circumstances does not relieve the taxpayer from liability for any additional tax

found to be due upon income of the taxable year. (See sections 57 and 272.)

The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently the only return required to be filed by the ancillary representative is on Form 1041, which shall be filed with the collector for his district and shall show the name and address of the domiciliary representative, the amount of gross income received by the ancillary representative, and the deductions to be claimed against such income, including any amount of income properly paid or credited by the ancillary representative to any legatee, heir, or other beneficiary. If the ancillary representative for the estate of a nonresident alien is a citizen or resident of the United States, and the domiciliary representative is a nonresident alien, such ancillary representative is required to render the return otherwise required of the domiciliary representative.

SEC. 143. *Withholding of tax at source.*—(a) *Tax-free covenant bonds.*—(1) *Requirement of withholding.*—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation, issued before January 1, 1934, contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein: *Provided*, That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall be at the following rates: (A) 10 per centum in the case of a nonresident alien individual (except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 per centum, as may be provided by treaty with such country), or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (B) in the case of such a foreign corporation, 15 per centum, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further*, That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 10 per centum.

(2) *Benefit of credits against net income.*—Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interests, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25 (b); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

(3) *Income of obligor and obligee.*—The obligor shall not be allowed a deduction for the payment of the tax imposed by this title, or any other tax paid pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

(b) *Nonresident aliens.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 10 per centum thereof, except that such rate shall be reduced, in the case of a nonresident alien individual a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country: *Provided*, That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (2) more than 85 per centum of the gross income of such corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119: *Provided further*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent. Under regulations prescribed by the Commissioner, with the approval of the Secretary, there may be exempted from such deduction and withholding the compensation for personal services of nonresident alien individuals who enter and leave the United States at frequent intervals.

(c) *Return and payment.*—Every person required to deduct and withhold any tax under this section shall make return thereof on or before March 15 of each year and shall on or before June 15, in lieu of the time prescribed in section 56, pay the tax to the official of the United States Government authorized to receive it. Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

(d) *Income of recipient.*—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) *Tax paid by recipient.*—If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

(f) *Refunds and credits.*—Where there has been an overpayment of tax under this section any refund or credit made under the provisions of section 322 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

ART. 143–1. *Withholding tax at source.*—(a) *Withholding in general.*—Withholding of a tax of 10 percent is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien individual (even though such individual is engaged in trade or business within the United States or has an office or place of business therein) or to a nonresident partnership, composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934 (but see paragraph (b) of this article), (3) dividends paid by a foreign corporation unless (A) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (B) more than 85 percent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under the provisions of section 119, (4) dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China, and (5) except that such rate of 10 percent shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 percent, as may be provided by treaty with such country. Under the regulations prescribed pursuant to the tax convention between the United States and Canada, the rate of tax to be withheld at the source has been reduced to 5 percent in the case of residents of Canada. (See page 668 of the Appendix to these regulations.)

The tax must be withheld at the source from the gross amount of any distribution made by a corporation, other than a nontaxable distribution payable in stock or stock rights or a distribution in partial or complete liquidation, without regard to any claim that all or a portion of such distribution is not taxable. Appropriate adjustments, if any, will be made upon the filing of claims for refund.

The tax must be withheld at the crued interest paid in connection with the sale of bonds between interest dates.

A tax of 10 percent must be withheld from interest on bonds or securities not containing a tax-free covenant, or containing a tax-free covenant and issued on or after January 1, 1934, if the owner

is unknown to the withholding agent, except where such interest represents income from sources without the United States.

For withholding in the case of income paid to nonresident foreign corporations, see article 144–1.

Resident or domestic fiduciaries are required to deduct the income tax at the source from all fixed or determinable annual or periodical gains, profits, and income of nonresident alien beneficiaries, to the extent that such items constitute gross income from sources within the United States. Bond interest, dividends, or other fixed or determinable annual or periodical income paid to a nonresident alien fiduciary is subject to withholding even though the beneficiaries of the estate or trust are citizens or residents of the United States.

The income of a trust created by a nonresident alien individual and taxable to the grantor under the provisions of section 166 or 167 is subject to withholding even though the beneficiaries of such trust are citizens or residents of the United States, and regardless of whether the beneficiaries are exempt from income tax.

A debtor corporation having an issue of bonds or other similar obligations which appoints a duly authorized agent to act in its behalf under the withholding provisions of the Act, is required to file notice of such appointment with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., giving the name and address of the agent.

If, in connection with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, must deduct and withhold such taxes as would be required to be withheld by the assignor had no such sale or transfer been made.

For determining income from sources within the United States, see section 119.

As to who are nonresident alien individuals, see articles 211–2 and 901–8. For classification of foreign corporations, see articles 231–1 and 901–8. As to what partnerships are deemed to be nonresident partnerships, see article 901–8.

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see articles 143–3 and 262–4.

(b) *Tax-free covenant bonds issued before January 1, 1934.*—The withholding provisions of section 143 (a) (1) are applicable only to bonds, mortgages, or deeds of trust, or other similar obligations of a corporation which were issued before January 1, 1934, and which contain a tax-free covenant. For the purpose of section 143 (a) (1) bonds, mortgages, or deeds of trust, or other similar obligations of a corporation, are issued when delivered. If a broker or other person acts as selling agent of the obligor the obligation is issued when delivered by the agent to the purchaser. If a broker or other person purchases the obligation outright for the purpose of holding or reselling it, the obligation is issued when delivered to such broker or other person.

In order that the date of issue of bonds, mortgages, or deeds of trust, or other similar obligations of corporations, containing a tax-free covenant may be readily determined by the owner, for the purpose of preparing the ownership certificates required under articles 143–1 to 143–9 the "issuing" or debtor corporation shall indicate, by an appropriate notation, the date of issue or use the phrase, "Issued on or after January 1, 1934," on each such obligation or in a statement accompanying the delivery of such obligation.

In cases where on or after January 1, 1934, the maturity date of bonds or other obligations of a corporation is extended, the bonds or other obligations shall be considered to have been issued on or after January 1, 1934. The interest on such obligations is not subject to the withholding provisions of section 143 (a) but falls within the class of interest described in section 143 (b).

In the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to an individual, a fiduciary or a partnership, whether resident or nonresident, withholding of a tax of 2 percent is required, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 percent of the interest, withholding is required at the rate of 10 percent in the case of a nonresident alien, or a nonresident partnership composed in whole or in part of nonresident alien individuals or if the owner is unknown to the withholding agent. The rates of withholding applicable to the interest on bonds or other obligations of a corporation containing a tax-free covenant, and issued before January 1, 1934, are applicable to interest on such obligations issued by a domestic corporation or a resident foreign corporation. However, withholding is not required in the case of interest payments on such bonds or obligations if such interest is not to be treated as income from sources within the United States under section 119 (a) (1) (B) and the payments are made to a nonresident alien or a partnership composed wholly of nonresident aliens. A nonresident foreign corporation having a fiscal or paying agent in the United States is required to withhold a tax of 2 percent upon the interest on its tax-free covenant bonds issued before January 1, 1934, paid to an individual or fiduciary who is a citizen or resident of the United States, or to a partnership any member of which is a citizen or resident, or to an unknown owner.

For withholding in the case of interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, paid to nonresident foreign corporations, see article 144–1.

Bonds issued under a trust deed containing a tax-free covenant are treated as if they contain such a covenant. If neither the bonds nor the trust deeds given by the obligor to secure them contained a tax-free covenant, but the original trust deeds were modified prior to January 1, 1934, by supplemental agreements containing a tax-free covenant executed by the obligor corporation and the trustee, the bonds issued prior to January 1, 1934, are subject to the provisions of section 143 (a), provided appropriate authority existed for the modification of the trust deeds in this manner. The authority must have been contained in the original trust deeds or actually secured from the bondholders.

In the case of corporate bonds or other obligations containing a tax-free covenant, issued before January 1, 1934, the corporation paying a Federal tax, or any part of it, for someone else pursuant to its agreement is not entitled to deduct such payment from its gross income on any ground nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of income tax due in accordance with section 143 (d). The tax withheld at the source upon tax-free covenant bond interest included in the income of an estate or trust and taxable to the beneficiaries thereof (including the grantor of a trust subject to section 166 or 167) is allowable, pro rata, as a credit against (1) the tax required to be withheld by the fiduciary from the income of nonresident alien beneficiaries and (2) against the total tax computed in the returns of the beneficiaries required to make returns. In the case, however, of corporate bonds or other obligations containing an appropriate tax-free covenant, the corporation paying for some one else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

ART. 143–2. *Fixed or determinable annual or periodical income.*—Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of

time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. The share of the income of an estate or trust from sources within the United States which is distributable, whether distributed or not, or which has been paid or credited during the taxable year to a nonresident alien beneciary of such estate or trust constitutes fixed or determinable annual or periodical income within the meaning of section 143 (b). The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income. Such items as taxes, interest on mortgages, or premiums on insurance paid to or for the account of a nonresident alien landlord by a tenant, pursuant to the terms of the lease, constitute fixed or determinable annual or periodical income.

ART. 143–3. *Exemption from withholding.*—Withholding from interest on bonds or other obligations of corporations issued prior to January 1, 1934, containing a tax-free covenant shall not be required in the case of a citizen or resident if he files with the witholding agent when presenting interest coupons for payment, or not later than February 1 of the following year, an ownership certificate on Form 1000 stating that his net income does not exceed his personal exemption and credit for dependents. To avoid inconvenience a resident alien should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., with a letter of transmittal.

The income of domestic corporations and of resident foreign corporations is free from withholding.

No withholding from dividends paid by a corporation organized under the China Trade Act, 1922, is required unless the dividends are treated as income from sources within the United States under section 119 and are distributed to—

(1) A nonresident alien other than a resident of China at the time of such distribution;

(2) A nonresident partnership composed in whole or in part of nonresident aliens (other than a partnership resident in China); or

(3) A nonresident foreign corporation (other than a corporation resident in China).

The salary or other compensation for personal services of a nonresident alien individual who enters and leaves the United States at frequent intervals, shall not be subject to deduction and withholding of income tax at the source, provided he is a resident of Canada or Mexico.

The following items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France, or a corporation organized under the laws of France, are not subject to the withholding provisions of the Revenue Act of 1938, since such income is exempt from Federal income tax under the provisions of the tax convention between the United States and France, signed April 27, 1932, and effective January 1, 1936 (see page 680 of the Appendix to these regulations):

(1) Amounts paid as consideration for the right to use patents, secret processes and formulas, trade-marks, and other analogous rights;

(2) Income received as copyright royalties; and

(3) Private pensions and life annuities.

The person paying such income should be notified by letter from the French citizen or corporation, as the case may be, that the income is exempt from taxation under the provisions of the convention and protocol referred to above. Such letter from a citizen of France shall contain his address and a statement that he is a citizen of France residing in France. The letter from such corporation shall contain the address of its office or place of business and a statement that it is a corporation organized under the laws of the Republic of France, and shall be signed by an officer of the corporation giving his official title. The letter of notification or a copy thereof should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year is subject to the tax imposed by section 211 (a) on gross income and is not entitled to any personal exemption or credit for dependents. Although a nonresident alien individual who is engaged in trade or business within the United States or has an office or place of business therein is entitled to the personal exemption of $1,000 (and a credit for dependents if he is a resident of Canada or Mexico), he is subject to the normal tax and the surtax imposed by sections 11 and 12 of the Act by reason of the provisions of section 211 (b) and the benefit of the personal exemption and credit for dependents may not be received by filing a claim therefor with the withholding agent.

ART. 143–4. *Ownership certificates for bond interest.*—In accordance with the provisions of section 147 (b), citizens and resident individuals and fiduciaries, resident partnerships and nonresident partnerships all of the members of which are citizens or residents, owning bonds, mortgages, or deeds of trust, or other similar obligations issued by a domestic corporation, a resident foreign corporation, or a nonresident foreign corporation having a fiscal agent or a paying agent in the United States, when presenting interest coupons for payment shall file ownership certificates for each issue of such obligations regardless of the amount of the coupons.

In the case of interest payments on overdue coupon bonds, the interest coupons of which have been exhausted, ownership certificates are required to be filed when collecting the interest in the same manner as if interest coupons were presented for collection.

In all cases where the owner of bonds, mortgages, or deeds of trust, or other similar obligations of a corporation is a nonresident alien, a nonresident partnership composed in whole or in part of nonresident aliens, a nonresident foreign corporation, or where the owner is unknown, an ownership certificate for each issue of such obligations shall be filed when interest coupons for any amount are presented for payment. The ownership certificate is required whether or not the obligation contains a tax-free covenant. However, ownership certificates need not be filed by a nonresident alien, a partnership composed wholly of nonresident aliens, or a nonresident foreign corporation in connection with interest payments on such bonds, mortgages, or deeds of trust or other similar obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B), or of a nonresident foreign corporation.

The ownership certificate shall show the name and address of the debtor corporation, the name and address of the owner of the obligations, a description of the obligations, the amount of interest and its due date, the rate at which tax is to be withheld, and the date upon which the interest coupons were presented for payment.

Ownership certificates need not be filed in the case of interest payments on obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States; or the obligations of the United States or its possessions. (See section 22 (b) (4).) Ownership certificates are not required to be filed in connection with interest payments on bonds, mortgages, or deeds of trust, or other similar obligations issued by an individual or a partnership. Ownership certificates are not required where the owner is a domestic corporation, a resident foreign corporation, or a foreign government.

When interest coupons detached from corporate bonds are received unaccompanied by ownership certificates, unless the owner of the bonds is known to the first bank to which the coupons are pre-

sented for payment, and the bank is satisfied that the owner is a person who is not required to file an ownership certificate, the bank shall require of the payee a statement showing the name and address of the person from whom the coupons were received by the payee, and alleging that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The bank shall also require the payee to prepare a certificate on Form 1001, crossing out "owner" and inserting "payee" and entering the amount of the interest on line 3, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

Ownership certificates are required in connection with interest payments on registered bonds as in the case of coupon bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates must be prepared by the withholding agent.

ART. 143–5. *Form of certificate for citizens or residents.*—For the purpose of article 143–4, Form 1000 shall be used in preparing ownership certificates of citizens or residents of the United States (individual or fiduciary), resident partnerships, and nonresident partnerships all of the members of which are citizens or residents. If the obligations are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation.

ART. 143–6. *Form of certificate for nonresident aliens, nonresident foreign corporations, and unknown owners.*—For the purpose of article 143–4, Form 1001 shall be used in preparing ownership certificates (*a*) of nonresident aliens, (*b*) of nonresident partnerships composed in whole or in part of nonresident aliens, (*c*) of nonresident foreign corporations, and (*d*) where the owner is unknown.

ART. 143–7. *Return and payment of tax withheld.*—Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on bonds or other obligations of corporations. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall also make a monthly return on Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. Such of the forms as report interest from which the tax is to be withheld should be listed on the monthly return. While the forms reporting interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted should be entered in the space provided. If Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see article 143–5), Forms 1012 and 1013 should be likewise modified.

Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 15 on Form 1042, showing the amount of tax required to be withheld from each nonresident alien, nonresident partnership composed in whole or in part of nonresident aliens, or nonresident foreign corporation to which income other than bond interest was paid during the previous taxable year. Form 1042 should be filed with the collector for the district in which the withholding agent is located. Every United States withholding agent shall make and file with the collector, in duplicate, an information return on Form 1042B, for the calendar year 1938 and each subsequent calendar year, in addition to the withholding return on Form 1042, with respect to the items of income from which a tax of only 5 percent was withheld from Canadian addressees. There shall be reported on Form 1042B not only such items of income listed on Form 1042, but also such items of interest listed on monthly returns on Form 1012, including items of interest where the liability for withholding is only 2 percent. In the case of corporations whose addresses are within Canada, only the fixed or determinable annual or periodical income from sources within the United States consisting of dividends should be reported.

In every case the tax withheld must be paid to the collector on or before June 15 of the following year. For penalties and additions to the tax attaching upon failure to make such returns or such payments, see sections 145 and 291.

If a debtor corporation has designated a person to act for it as withholding agent, and such person has not withheld any tax from the income nor received any funds from the debtor corporation to pay the tax which the debtor corporation assumed in connection with its tax-free covenant bonds, such person cannot be held liable for the tax assumed by the debtor corporation merely by reason of such person's appointment as withholding agent. If a duly authorized withholding agent has become insolvent or for any other reason fails to make payment to the collector of internal revenue of money deposited with it by the debtor corporation to pay taxes, or money withheld from bondholders, the debtor corporation is not discharged of its liability under section 143 (a) (1), since the withholding agent is merely the agent of the debtor corporation.

In any case where income is payable in any medium other than money, the withholding agent shall not release the property so received until it has been placed in funds sufficient to enable it to pay over in money the tax required to be withheld with respect to such income.

ART. 143–8. *Ownership certificates in the case of fiduciaries and joint owners.*—If fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. The ownership certificate should show the name of the estate or trust, in addition to the name and address of the fiduciary. If bonds are owned jointly by two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 143–9. *Return of income from which tax was withheld.*—The entire amount of the income from which the tax was withheld shall be included in gross income in the return required to be made by the recipient of the income without deduction for such payment of the tax but any tax so withheld shall be credited against the total income tax as computed in the taxpayer's return. (See, however, article 142–5.) If the tax is paid by the recipient of the income or by the withholding agent it shall not be re-collected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

Tax withheld at the source upon fixed or determinable annual or periodical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income. Accordingly, if a person is subject to the taxes imposed by section 11, 12, 13, or 14 upon any portion of the income of a nonresident alien estate or trust, the part of any tax withheld at the source which is properly allocable to the income so taxed to such person shall be credited against the amount of the income tax computed upon his return, and any excess shall be credited against any income, war profits, or excess-profits tax, or installment thereof, then due from such person, and any balance shall be refunded.

SEC. 144. *Payment of corporation income tax at source.*—In the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 143 a tax equal to 15 per centum thereof, except that in the case of dividends the rate shall be 10 per centum, and except that in the case of corporations organized under the laws of a contiguous country such rate of 10 per centum with respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country; and such tax shall be returned and paid in the same manner and subject to the same conditions as pro-

vided in that section: *Provided*, That in the case of interest described in subsection (a) of that section (relating to tax-free covenant bonds) the deduction and withholding shall be at the rate specified in such subsection.

ART. 144–1. *Withholding in the case of nonresident foreign corporations.*—A tax of 15 percent is required to be withheld in the case of fixed or determinable annual or periodical income paid to a nonresident foreign corporation except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to such corporation, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934, where the liability assumed by the obligor exceeds 2 percent of the interest, and (3) dividends.

Withholding of a tax at the rate of 2 percent is required in the case of interest paid to a nonresident foreign corporation, upon bonds or other obligations of a corporation issued prior to January 1, 1934, and containing a tax-free covenant, if the liability assumed by the obligor exceeds 2 percent of the interest and the interest is treated as income from sources within the United States.

A tax of 10 percent is required to be withheld from dividends (other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a resident of China) from sources within the United States paid to a nonresident foreign corporation, except that such rate of 10 percent shall be reduced, in the case of corporations organized under the laws of a contiguous country, to such rate (not less than 5 percent) as may be provided by treaty with such country. (See page 668 of the Appendix to these regulations.) Dividends paid by a foreign corporation are not, however, subject to withholding unless such corporation is engaged in trade or business within the United States or has an office or place of business therein and more than 85 percent of the gross income of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119. (See also section 143.)

For withholding in the case of dividends distributed by a corporation organized under the China Trade Act, 1922, see articles 143–3 and 262–4.

ART. 144–2. *Aids to withholding agents in determining liability for withholding of tax.*—Since no withholding of tax on bond interest, dividends, or other income is required in the case of a resident foreign corporation (see article 143–3), the person paying such income should be notified by a letter from such corporation that it is not subject to the withholding provisions of the Act. The letter from the corporation shall contain the address of its office or place of business in the United States and be signed by an officer of the corporation giving his official title. Such letter of notification, or copy thereof, should be immediately forwarded by the recipient to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C. The same procedure should be followed in the case of resident partnerships, composed in whole or in part of nonresident aliens, not subject to the withholding provisions of the Act except in the case of interest on tax-free covenant bonds. The letter should be signed by a member of the firm.

When a payor corporation, or any other person (including a nominee), having the control, receipt, custody, disposal, or payment of dividends has no definite knowledge of the status of the shareholder, the tax should be withheld if the shareholder's address is outside the United States. If the shareholder's address is within the United States, it may be assumed that such shareholder is a citizen or a resident thereof. Unless the name and style of the shareholder are such as to indicate clearly that he is a nonresident alien, an address in care of another person in the United States does not of itself warrant the treating of the shareholder as a nonresident alien. If a shareholder changes his address from a place without the United States to a place within the United States, the tax should be withheld unless proof is furnished showing that he is a citizen or a resident of the United States. A person's written statement that he is a citizen, or resident of the United States, may be relied upon by the payor of income as proof that such person is a citizen or resident of the United States.

The following table of withholding rates under the Revenue Act of 1938 and the tax convention between the United States and Canada has been prepared for the purpose of making a summary of such rates readily available to withholding agents:

Classes of taxpayers	Corporate bond interest			Dividends from domestic corporation	Dividends from foreign corporation mentioned in article 143–1	Salary or other compensation for personal services	Other fixed or determinable annual or periodical income from sources within the United States
	With tax-free covenant and issued before Jan. 1, 1934		Without tax-free covenant or issued on or after Jan. 1, 1934, with tax-free covenant				
	If corporation assumes over 2 percent of the tax	If corporation assumes not over 2 percent of the tax					
1. Citizen or resident individual, fiduciary, or partnership	*Percent* 2	*Percent* 2	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
2. Nonresident individual, fiduciary, or partnership (except as stated in item 5 below)	2	10	10	10	10	[1] 10	10
3. Domestic corporation or resident foreign corporation							
4. Nonresident foreign corporation (except as stated in item 6 below)	2	15	15	10	10	15	15
5. Individual, fiduciary, or partnership, resident of Canada	2	5	5	5	5	([1])	5
6. Nonresident corporation organized under laws of Canada	2	15	15	5	5	15	15
7. Unknown owner	2	10	10				

[1] Salary or compensation for personal services rendered in the United States is not subject to withholding in the case of nonresident aliens, residents of Canada or Mexico, who enter and leave the United States at frequent intervals.

SEC. 145. *Penalties.*—(a) Any person required under this title to pay any tax, or required by law or regulations made under authority thereof to make a return, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any tax imposed by this title, who willfully fails to pay such tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution.

(b) Any person required under this title to collect, account for, and pay over any tax imposed by this title, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(c) The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

(d) For penalties for failure to file information returns with respect to foreign personal holding companies and foreign corporations, see section 340.

ART. 145–1. *Penalties.*—The penalties provided for in section 145 cannot be assessed but are enforceable only by suit or prosecution. For limitations on prosecutions, see the Act of July 5, 1884, as amended by section 1108 of the Revenue Act of 1932 (paragraph 51 of the Appendix to these regulations). The willful failure of a taxpayer to give information required in his return as to advice or assistance rendered in the preparation of the return, and the willful failure of the person preparing a return for another to execute the sworn statement required with reference thereto, make such per-

sons subject to the penalties imposed by section 145 (a). The privilege against incrimination in the fifth amendment to the Constitution is not a defense to a charge of failure to file a return, and does not authorize a refusal to state the amount of income, though the taxpayer's income was made through crime.

SEC. 146. *Closing by commissioner of taxable year.*—(a) *Tax in jeopardy.*—(1) *Departure of taxpayer or removal of property from United States.*—If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(2) *Corporation in liquidation.*—If the Commissioner finds that the collection of the tax of a corporation for the current or last preceding taxable year will be jeopardized by the distribution of all or a portion of the assets of such corporation in the liquidation of the whole or any part of its capital stock, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the last preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable.

(b) *Security for payment.*—A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this section, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress.

(c) *Same—Exemption from section.*—If security is approved and accepted pursuant to the provisions of this section and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such respective taxes.

(d) *Citizens.*—In the case of a citizen of the United States or of a possession of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(e) *Departure of alien.*—No alien shall depart from the United States unless he first procures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(f) *Addition to tax.*—If a taxpayer violates or attempts to violate this section there shall, in addition to all other penalties, be added as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 6 per centum per annum from the time the tax became due.

ART. 146–1. *Termination of the taxable period by Commissioner.*—(a) Section 146 provides that in the case of a taxpayer who designs by immediate departure from the United States or otherwise to avoid the payment of the tax for the preceding or current taxable year, the Commissioner may upon evidence satisfactory to him, declare the taxable period for such taxpayer immediately terminated and cause to be served upon him notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid. In such a case the taxpayer is entitled to the personal exemption and credit for dependents, if otherwise allowable, but the amount allowable as personal exemption and credit for dependents shall be reduced proportionately to the length of the period for which the return is made. If suit is necessary to collect a tax made due and payable by the provisions of section 146 (a) (1), the Commissioner's finding is presumptive evidence of the taxpayer's design. Section 146 (a) (2) provides for a similar termination of the taxable period of a corporation if the Commissioner finds that the collection of the tax of the corporation for the current or last preceding taxable year will be jeopardized by the distribution of all or a portion of the assets of such corporation in the liquidation of the whole or any part of its capital stock. Such finding of the Commissioner is considered prima facie correct. A taxpayer who is not in default in making the returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes which are or may be due pursuant to this article by depositing with the Commissioner United States bonds of a principal amount not exceeding double the amount of taxes due for the taxable period, or by furnishing such other security as may be approved by the Commissioner.

(b) Except as provided in paragraph (c) of this article an alien who intends to depart from the United States will be required to file a return of income on Form 1040C and to obtain a certificate of compliance with income tax obligations from the collector or internal revenue agent in charge. A certificate of compliance is attached to and made a part of Form 1040C. An alien, whether resident or nonresident, who intends to depart from the United States should appear before the collector or internal revenue agent in charge for the district in which he resides and satisfy all income tax obligations with respect to income received or to be received, determined as nearly as may be, up to and including the date of his intended departure. Upon payment of such obligations, or upon the furnishing of such security as may be approved by the Commissioner for the payment of such obligations, or upon satisfactory evidence that no tax is due and payable, the collector or internal revenue agent in charge will issue a certificate of compliance to the applicant. A properly executed certificate of compliance issued by the collector or internal revenue agent must be presented at the point of departure. An alien presenting himself at the point of departure without such certificate of compliance will be examined by an internal revenue officer at that point and such taxes as appear to be due and owing will be collected. Citizens of the United States or of possessions of the United States departing from the United States will not be required to procure certificates of compliance or to present any other evidence of compliance with income tax obligations.

(c) An alien who intends to depart from the United States and whose taxable year has not been terminated by the Commissioner as provided in section 146 (a), and who is not in default in making any return, or paying income, war-profits, or excess-profits tax under any Act of Congress, may procure a certificate of compliance as provided in section 146 (e) by (1) appointing in writing on Form 934 an attorney in fact, resident in the United States, to make his income tax return or returns for the taxable year current at the time of his intended departure and for the next preceding taxable year (if not already made), (2) making on Form 1040D a return of information for his taxable year current at the time of his intended departure and a return on that form for the next preceding taxable year where the period for making the income tax return for the next preceding taxable year has not expired, and (3) either paying the estimated tax as shown on the information return (Form 1040D), which will be credited on account for the year covered by such return, or furnishing security approved by the Commissioner that he will make the required return or returns and pay the tax or taxes required to be paid. If such security is approved and accepted and such further security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes may be postponed until the expiration of the time otherwise allowed for their payment. The departing alien may furnish as security a surety bond on Form 1133 in an amount

not exceeding double the amount of tax for his taxable year current at the time of his intended departure, and for the next preceding taxable year (if not already paid), conditioned upon the making of his return or returns for such year or years (if not already made), and the payment of any tax or taxes that may become payable for such year or years together with any penalty and interest that may accrue thereon, such bond to be executed by a surety or sureties approved by the Commissioner. In lieu of such a surety bond, the taxpayer may furnish as security a penal bond (Form 1133), approved by the Commissioner, secured by deposit of bonds or notes of the United States equal in their total par value to an amount not exceeding double the amount of the tax or taxes in respect of which the bond is furnished. A form of a "certificate of compliance" is made a part of Form 1040D. Bonds complying with the provisions of this article, if properly executed and with adequate surety, are approved, and may be accepted in the name of the Commissioner, by the collector or internal revenue agent in charge by signing the Form 1133 as follows:

Commissioner of Internal Revenue.

By ---

(Collector of Internal Revenue.)

(Internal Revenue Agent in Charge.)

A corporation will not be accepted as a surety on such bond unless the corporation holds a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds. If the surety on the bond is an individual or individuals such bond shall not be accepted until an investigation is made as to the financial and other responsibility of such surety or sureties and such investigation shows that the collection of the tax is amply secured by the bond.

SEC. 147. *Information at source.*—(*a*) *Payments of $1,000 or more.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another person, of interest, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 148 (a) or 149), of $1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(*b*) *Returns regardless of amount of payment.*—Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(*c*) *Recipient to furnish name and address.*—When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(*d*) *Obligations of United States.*—The provisions of this section shall ont apply to the payment of interest on obligations of the United States.

ART. 147–1. *Return of information as to payments of $1,000.*—All persons making payment to another person of fixed or determinable income of $1,000 or more in any calendar year must render a return thereof to the Commissioner for such year on or before February 15 of the following year, except as specified in articles 147–3 to 147–5. A return shall be made in each case on Form 1099, accompanied by transmittal Form 1096 showing the number of returns filed, except that the return with respect to distributions to beneficiaries of a trust or of an estate shall be made on Form 1041 in lieu of Forms 1099 and 1096. The street and number where the recipient of the payment lives should be stated, if possible. If no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical. (See article 143–2.)

Sums paid in respect of life insurance, endowment or annuity contracts which are required to be included in gross income under articles 22 (b) (1)–1, 22 (b) (2)–1, and 22 (b) (2)–2 come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this article, except that payments in respect of policies surrendered before maturity and lapsed policies need not be reported.

Fees for professional services paid to attorneys, physicians, and members of other professions come within the meaning of the term "fixed or determinable income" and are required to be reported in returns of information as required by this article.

For the purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and which is made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

ART. 147–2. *Return of information as to payments to employees.*—The names of all employees to whom payments of $1,000 or over a year are made, whether such total sum is made up of wages, salaries, commissions, or compensation in any other form, must be reported. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. Amounts distributed or made available under an employees' trust governed by the provisions of section 165 to any beneficiary in any taxable year, in excess of the sum of his personal exemption and the amounts paid into the fund by him, must be reported by the trustee. But see article 147–3. (See also article 22 (a)–3.)

In the case of payments made by the United States to persons in its service (civil, military, or naval) of wages, salaries, or compensation in any other form, the returns of information shall be made by the heads of the executive departments and other United States Government establishments.

ART. 147–3. *Cases where no return of information required.*—Payments of the following character, although over $1,000, need not be reported in returns of information on Form 1099:

(*a*) Payments of interest on obligations of the United States;

(*b*) Payments by a broker to his customers;

(*c*) Payments of any type made to corporations;

(*d*) Bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges;

(*e*) Payments of rent made to real estate agents (but the agent must report payments to the landlord if the amount paid during the year was $1,000 or more);

(*f*) Payments made to alien employees serving in foreign countries or payments representing earned income for services rendered without the United States made to nonresident citizens entitled to the benefits of section 116 (a);

(*g*) Salaries and profits paid or distributed by a partnership to the individual partners;

(*h*) Payments of salaries, or other compensation for personal services aggregating less than $2,500 made to a married individual (citizen or resident);

(*i*) Payments of commissions made by fire insurance companies, or other companies insuring property, to general agents, except when specifically directed by the Commissioner to be filed;

(*j*) Payments of income upon which income tax has been withheld at the source and reported on Forms 1012, 1013, or 1042; and

(*k*) Amounts paid by the United States to persons in its service (civil, military, or naval) as an allowance for traveling expenses, including an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, and amounts paid as reimbursements for traveling expenses.

If the marital status of the payee is unknown to the payor, or if the marital status of the payee changed during the year (see article 25–7), or if the payee is a resident of Canada or Mexico, the payee will be considered a single person for the purpose of filing a return of information on Form 1099 with respect to payments of salaries or other compensation for personal services.

ART. 147–4. *Return of information as to interest on corporate bonds.*—In the case of payments of interest, regardless of amount, upon bonds and similar obligations of corporations, the ownership certificates, when duly filed, shall constitute and be treated as returns of information. (See article 143–5.)

ART. 147–5. *Return of information as to payments to other than citizens or residents.*—In the case of payments of fixed or determinable annual or periodical income to nonresident aliens (individual or fiduciary), to nonresident partnerships composed in whole or in part of nonresident aliens, or to nonresident foreign corporations (see article 901–8), the returns filed by withholding agents on Form 1042 shall constitute and be treated as returns of information. (See sections 143 and 144.)

ART. 147–6. *Foreign items.*—The term "foreign items," as used in these regulations, means any item of interest upon the bonds of a foreign country or of a nonresident foreign corporation not having a fiscal or paying agent in the United States, or any item of dividends upon the stock of such corporation.

ART. 147–7. *Return of information as to foreign items.*—In the case of foreign items, an information return on Form 1099 is required to be filed by the bank or collecting agent accepting the items for collection, if the foreign item is paid to a citizen or resident of the United States (individual or fiduciary), or a partnership any member of which is a citizen or resident, and if the amount of the foreign items paid in any taxable year to an individual, a partnership, or a fiduciary is $1,000 or more. Such forms accompanied by Form 1096 should be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before February 15 of each year. The term "collection" includes the following: (*a*) The payment by the licensee of the foreign item in cash; (*b*) the crediting by the licensee of the account of the person presenting the foreign item; (*c*) the tentative crediting by the licensee of the account of the person presenting the foreign item until the amount of the foreign item is received by the licensee from abroad; and (*d*) the receipt of foreign items by the licensee for the purpose of transmitting them abroad for deposits. (See articles 147–1 and 147–3.)

ART. 147–8. *Information as to actual owner.*—When the person receiving a payment falling within the provisions of the Act for information at the source is not the actual owner of the income received, the name and address of the actual owner or payee shall be furnished upon demand of the individual, corporation, or partnership paying the income, and in default of a compliance with such demand the payee becomes liable for the penalties provided. (See section 145.) Dividends on stock are prima facie the income of the record owner of the stock. Upon receipt of dividends by a record owner, he should execute Form 1087 to disclose the name and address of the actual owner or payee. Form 1087 should be filed with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than February 15 of the succeeding year. Unless such a disclosure is made, the record owner will be held liable for any tax based upon such dividends. (See article 148–1.)

The filing of Form 1087 is not required (*a*) if the record owner is required to file a fiduciary return on Form 1041, or a withholding return on Form 1042, disclosing the name and address of the actual owner or payee, or (*b*) if the actual owner or payee is a nonresident alien individual, foreign partnership, or foreign corporation and the 10 percent tax has been withheld at the source prior to receipt of the dividends by the record owner. (See article 143–1.)

SEC. 148. *Information by corporations.*—(*a*) *Dividend payments.*—Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him.

(*b*) *Profits declared as dividends.*—Every corporation shall, when required by the Commissioner, furnish him a statement of such facts as will enable him to determine the portion of the earnings or profits of the corporation (including gains, profits, and income not taxed) accumulated during such periods as the Commissioner may specify, which have been distributed or ordered to be distributed, respectively, to its shareholders during such taxable years as the Commissioner may specify.

(*c*) *Accumulated earnings and profits.*—When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of accumulated earnings and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

(*d*) *Contemplated dissolution or liquidation.*—Every corporation shall, within thirty days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, render a correct return to the Commissioner, verified under oath, setting forth the terms of such resolution or plan and such other information as the Commissioner shall, with the approval of the Secretary, by regulations prescribe.

(*e*) *Distributions in liquidation.*—Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its distributions in liquidation, stating the name and address of each shareholder, the number and class of shares owned by him, and the amount paid to him or, if the distribution is in property other than money, the fair market value (as of the date the distribution is made) of the property distributed to him.

(*f*) *Compensation of officers and employees.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, every corporation subject to taxation under this title shall, in its return, submit a list of the names of all officers and employees of such corporation and the respective amounts paid to them during the taxable year of the corporation by the corporation as salary, commission, bonus, or other compensation for personal services rendered, if the aggregate amount so paid to the individual is in excess of $75,000. The Secretary of the Treasury shall compile from the returns made a list containing the names of, and the amounts paid to, each such officer and employee and the name of the paying corporation, and shall make such list available to the public.

ART. 148–1. *Return of information as to payments of dividends.*—Section 148 provides that every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him. In accordance with that section, returns of information in respect of dividend payments shall be rendered for each calendar year as follows:

(*a*) Except as provided in paragraph (*b*) below, every domestic corporation or foreign corporation engaged in business within the United States or having an office or place of business or a fiscal or paying agent in the United States, making payments of dividends and distributions (other than distributions in liquidation) (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year) without regard to the amount of the earnings and profits at the time the distribution was made, to any shareholder who is an individual (citizen or resident of the United States), a resident fiduciary, or a resident partnership any member of which is a citizen or resident, amounting to $100 or more during each calendar year, shall render an information return on Forms 1096 and 1099. A separate Form 1099 must be prepared for each shareholder, upon which will be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by a letter of transmittal on Form 1096 showing the number of Forms 1099 filed therewith, shall be filed with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before February 15 of the following year.

The periodical distributions of earning on running installment shares of stock paid or credited by a building and loan association to its holders of that class of stock are dividends within the meaning of section 115 (a). The sum received upon withdrawal from a building and loan association in excess of

the amounts paid in on account of membership fees and stock subscriptions, consisting of accumulated profits, constitutes a dividend within the meaning of section 115 (a). As to when a stock dividend is taxable as a dividend see section 115 (f).

(b) In cases of distributions which are made from a depletion or depreciation reserve, or which for any other reason are deemed by the corporation to be nontaxable or partly nontaxable to its shareholders, the corporation will first fill in the information on the reverse side of Form 1096 and forward this form to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than February 1 of the following year. Upon receipt of this information the Commissioner will determine and advise the corporation by letter whether any portion of such distribution is subject to tax. The corporation after receiving this letter will then properly prepare for each shareholder a Form 1099, which shall be forwarded with Form 1096 to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than 30 days after such letter is received.

In any case in which it is impossible to file the return within the time prescribed in this article, the corporation may, upon a showing of such fact, obtain a reasonable extension of time for filing the return. The request for the extension of time must be forwarded to the Commissioner of Internal Revenue, Practice and Procedure Division, Washington, D. C., on or before the date prescribed for filing the return.

ART. 148–2. *Return of information respecting contemplated dissolution or liquidation—(a) Making and filing of returns.*—Within 30 days after the adoption on or after May 28, 1938, of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock, the corporation shall file with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Records Division, a correct return on Form 966, made under oath or affirmation and containing the information required by paragraph (b) of this article and by such form. A like return shall be filed by the corporation in the case of any amendment of, or supplement to, a resolution or plan for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock adopted on, before, or after May 28, 1938, if such amendment or supplement was adopted on or after May 28, 1938. A return must be filed under section 148 (d) in respect of a liquidation whether or not any part of the gain or loss to the shareholders upon the liquidation is recognized under the provisions of section 112.

(b) *Contents of return.*—(1) *General.*—There shall be attached to and made a part of the return required by section 148 (d) and paragraph (a) of this article a certified copy of the resolution or plan, together with any amendments thereof or supplements thereto, and such return shall in addition contain the following information:

(i) The name and address of the corporation;

(ii) The place and date of incorporation;

(iii) The date of the adoption of the resolution or plan and the dates of any amendments thereof or supplements thereto; and

(iv) The collection district in which the last income tax return of the corporation was filed and the taxable year covered thereby.

(2) *Liquidation in December, 1938.*—In the event that the corporation is a domestic corporation and the plan of liquidation (adopted after May 28, 1938) provides for a distribution in complete cancellation or redemption of all the capital stock of the corporation, and for the transfer of all the property of the corporation under the liquidation entirely within the month of December, 1938, such return shall, in addition to the information required by paragraph (b) (1) of this article, contain the following information:

(i) A statement showing the number of shares of each class of stock outstanding on the date of the adoption of the plan of liquidation, together with a description of the voting power of each such class;

(ii) A list of all the shareholders owning stock on the date of the adoption of the plan of liquidation, together with the number of shares of each class of stock owned by each shareholder, the certificate numbers thereof, and the total number of votes to which entitled on the adoption of the plan of liquidation; and

(iii) A list of all corporate shareholders as of April 9, 1938, together with the number of shares of each class of stock owned by each such shareholder, the certificate numbers thereof, the total number of votes to which entitled on the adoption of the plan of liquidation, and a statement of all changes in ownership of stock by corporate shareholders between April 9, 1938, and the date of the adoption of the plan of liquidation, both dates inclusive.

(3) *Returns in respect of amendments or supplements.*—If a return in respect of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock has already been filed pursuant to section 148 (d), a return in respect of any amendment thereof or supplement thereto will be deemed sufficient if it gives the date such prior return was filed and contains a duly certified copy of such amendment or supplement and all other information required by this article and by Form 966 which was not given in such prior return. If no return was filed relative to the resolution or plan which is being amended or supplemented, the return relative to the amendment thereof or supplement thereto shall contain a duly certified copy of the resolution or plan which is being amended or supplemented, together with all amendments thereof and supplements thereto, and all other information required by this article and by Form 966.

ART. 148–3. *Return of information respecting distributions in liquidation.*—Unless the distribution is one in respect of which information is required to be filed pursuant to article 112 (b) (6)–5 (b), 112 (g)–6 (a), or 371–10, every corporation making any distribution in liquidation of the whole or any part of its capital stock shall file a return of information on Forms 1096 and 1099L, giving all the information required by such forms and by these regulations. A separate Form 1099L must be prepared in duplicate for each shareholder to whom such distribution was made, showing the name and address of such shareholder, the number and class of shares owned by him in liquidation of which such distribution was made, and the total amount distributed to him on each class of stock. If the amount distributed to such shareholder on any class of stock consisted in whole or in part of property other than money, the return on such form shall in addition show the amount of money distributed, if any, and shall list separately each class of property other than money distributed, giving a description of the property in each such class and a statement of its fair market value at the time of the distribution.

Such duplicate forms, accompanied by a letter of transmittal on Form 1096 showing the number of Forms 1099L filed therewith, shall be filed with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before February 15 of the year following the calendar year in which such distribution was made. If the distribution is in complete liquidation of a domestic corporation pursuant to a plan of liquidation adopted after May 28, 1938, in accordance with which all the capital stock of the corporation is canceled or redeemed and the transfer of all the property under the liquidation occurs in the month of December, 1938, the return on Form 1096 shall show (1) the amount of earnings and profits of the corporation accumulated after February 28, 1913, determined as of December 31, 1938, but without diminution by reason of distributions made during the month of December, 1938, (2) the ratable share of such earnings and profits of each share of stock canceled or redeemed in the liquidation, and (3) the date and circumstances of the acquisition by the corporation of any stock or securities distributed to shareholders in the liquidation.

ART. 148–4. *Information respecting compensation of officers and employees in excess of $75,000.*—Every corporation sub-

ject to taxation under Title I which during any taxable year beginning on or after January 1, 1938, has paid to any officer or employee of the corporation, salary, commission, bonus, or other compensation for personal services rendered, in an aggregate amount in excess of $75,000 (in whatever form paid), shall in respect of each such taxable year, make and file, in duplicate, Schedule H–1, as a part of its income tax return, in accordance with the instructions contained in the prescribed return. Such schedule shall contain the following information: (1) Name of officer or employee, (2) amount of salary paid, (3) amount of commission paid, (4) amount of bonus paid, (5) amount of other compensation paid, and (6) total compensation paid.

The term "paid" as used in this article means "paid or accrued" or "paid or incurred" which shall be construed according to the method of accounting upon the basis of which the net income of the corporation is computed.

Upon receipt of the returns by the collector, the schedules will be detached and forwarded by the collector to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

SEC. 149. *Returns of brokers.*—Every person doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such person has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

ART. 149–1. *Return of information by brokers.*—Every person or organization acting as broker or other agent in stock, bond, or commodity transactions (including banks which handle orders for depositors or custodian accounts) is hereby directed to make an annual return of information on Form 1100 for each customer, depositor, or account for whom or which the total amount of either the purchases or sales of securities or commodities, for the customer, or the total market value of the securities exchanged for the customer, is $25,000 or more during the calendar year 1938 and each subsequent calendar year, except as provided in this article or as otherwise specifically directed by the Commissioner. The form shall show the name and address of the customer and the title of the account; the name and address of the broker or agent; the names and addresses of the guarantor of the account and others with power to make withdrawals of cash, securities, or commodities from the account; and, except as provided in the fourth paragraph of this article, the form shall also show the total of the purchases, the total of the sales, and the total market value of the securities exchanged for the customer or account.

The making of Form 1100 by banks and trust companies may be confined to cases involving sales and exchanges for customers aggregating $25,000 or more during the year, and the dollar totals may be omitted from the Form 1100. It is to be understood, however, that such a form shall be made for each case involving sales and exchanges aggregating $25,000 or more during each year.

Banks and trust companies will not be required to file Form 110 covering purchases, sales, or exchanges made by them when acting for themselves or as executor, administrator, trustee, or in any other fiduciary capacity (not including custodian or safe-keeping accounts as fiduciary), or for other banks, trust companies, brokers, or other financial institutions doing business in the United States. Banks and trust companies will not be required to file returns covering purchases and sales where they do not actually give the orders for the purchases and sales.

Brokers and other agents handling purchases and sales of commodities for customers may report on Form 1100 for each year either the total profit or loss of each customer on all of such transactions, when $500 or more, in lieu of the total purchases or sales of $25,000 or more. If the profit or loss is reported a Form 1100 should be prepared for each customer whenever the amount of the total profit or loss of the customer from all such transactions is $500 or more for the calendar year, and the form should be noted accordingly.

Persons or organizations having domestic correspondents will not report on Form 1100 for such domestic correspondents inasmuch as each correspondent will report for his or its individual customers.

Form 1100 is printed on white paper and a duplicate thereof is printed on pink paper. In each case where the account is guaranteed or others have power to make withdrawals of cash, securities, or commodities from the account, a duplicate of the form as prepared on white paper shall be made on the pink form for each name and address, other than the customer, required to be shown on Form 1100.

Form 1100A is provided for use as a letter of transmittal and affidavit to accompany Forms 1100. The Forms 1100 for each year accompanied by Forms 1100A, properly filled out and executed, shall be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than February 15, following the close of the calendar year. The forms will be distributed through the collectors of internal revenue for the various collection districts.

Returns made by individuals must be sworn to by the individual or his duly authorized agent. Returns made by corporations, partnerships, and other organizations must be signed and sworn to by an officer or member of the organization.

SEC. 150. *Collection of foreign items.*—All persons undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000 or imprisoned for not more than one year, or both.

ART. 150–1. *License to collect foreign items.*—Banks or agents collecting foreign items, as defined in article 147–6, and required by article 147–7 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application Form 1017 for such license may be procured from collectors. The license is issued without cost on Form 1010. Any person holding a license under the Revenue Act of 1936 or any prior Act will not be required to renew such license.

SEC. 151. *Foreign personal holding companies.*—For information returns by officers, directors, and large shareholders, with respect to foreign personal holding companies, see sections 338, 339, and 340.

CHAPTER XXIII

Estates and Trusts

Supplement E—Estates and Trusts

SEC. 161. *Imposition of tax.*—(a) *Application of tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by fiduciary, see section 142.

ART. 161–1. *Imposition of the tax—(a) Scope.*—Supplement E prescribes that the taxes imposed upon individuals by Title I shall be applicable to the income of estates or of any kind of property held in trust. The rate of tax, the statu-

tory provisions respecting gross income, and, with certain exceptions, the deductions and credits allowed to individuals apply also to estates and trusts.

The several classes enumerated and described in the four paragraphs of section 161 (a), and which are introduced by the word "including," do not exclude others which also may come within the general purpose of that subsection.

A guardian, whether of an infant or other person, is a fiduciary (see section 901 (a) (6)), and, as such, is required to make and file the return for his ward and pay the tax, or the return may be made by the ward. (See articles 51–1 and 142–2.) The estate of a ward is not a taxable entity, in that respect differing from the estate of a deceased person or of a trust.

The provisions of sections 161, 162, and 163 (relating to estates and trusts, fiduciaries, and beneficiaries) contemplate that the corpus of the trust, or the income therefrom, is, within the meaning of the Act, no longer to be regarded as that of the grantor. If, by virtue of the nature and purpose of the trust, the corpus or income therefrom remains attributable to the grantor, these provisions do not apply. Thus the provisions of sections 166 and 167 deal with certain trusts which are excluded from the scope of sections 161, 162, and 163. Other trusts, not specified in sections 166 and 167, where in contemplation of law the corpus of the trust or the income therefrom is regarded as remaining in substance that of the grantor are likewise excluded from the scope of sections 161, 162, and 163. Some of such trusts are dealt with in article 166–1 and article 167–1. See section 165 as to the exemption of employees' trusts.

(b) *Taxability of the income.*—The fiduciary is required to make and file the return and pay the tax on the net income of the estate or trust except as otherwise provided in sections 165, 166, and 167, and articles 166–1 and 167–1. In determining whether there is any net income subject to tax and the amount thereof, consideration is to be given to the additional deductions authorized in section 162.

SEC. 162. *Net income.*—The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purpose and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficaries,[1] and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

ART. 162–1. *Income of estates and trusts.*—In ascertaining the tax liability of the estate of a deceased person or of a trust, there is deductible from the gross income, subject to exceptions, the same deductions which are allowed to individual taxpayers. See generally section 23, and the provisions thereof governing the right of deduction for depreciation and depletion in the case of property held in trust. For items not deductible, see section 24. Against the net income of the estate or trust there are allowable certain credits, for which see sections 25 and 163.

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this article) the following:

(1) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in subsection (a) of section 162. This deduction is in lieu of that authorized by section 23 (o) in the case of individual taxpayers.

(2) Any income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to a beneficiary, whether or not such income is actually distributed.

(3) Any income of the estate of a deceased person for its taxable year which is properly paid or credited during such year to a legatee or heir, and any income either of such an estate or of a trust for its taxable year which is similarly paid or credited during that year to a legatee, heir, or beneficiary if there was vested in the fiduciary a discretion either to distribute or to accumulate such income.

Any income of the class described in either (2) or (3) above, which is currently distributable, or paid or credited, to a guardian for his ward is likewise deductible from the gross income of the estate or trust.

There is taxable to the estate or to the trust, unless it be taxable to the grantor of the trust (see articles 166–1 and 167–1), all income thereof accumulated for the benefit of unborn or unascertained persons or persons with contingent interests, all income either accumulated or held for future distribution pursuant to the terms of the will or trust, all income of the estate or trust for its taxable year which is not to be distributed currently to legatees or other beneficiaries (see paragraph (2) of this article), all income of the estate for its taxable year not properly paid or credited during such year to a legatee or heir, and all income either of the estate or of the trust for its taxable year which is not similarly paid or credited during that year to a legatee, heir, or beneficiary in case there was vested in the fiduciary a discretion either to distribute or to accumulate such income (see paragraph (3) of this article). In all such cases the tax is payable by the fiduciary, except the tax upon the income which is taxable to the grantor of the trust.

Any amount described in paragraph (2) or (3) above as being deductible from the gross income of the estate or trust shall be included in computing the net income of the legatees, heirs, or beneficiaries, whether distributed to them or not.

Any income of an estate or trust for its taxable year which during that year may be used, pursuant to the terms of the will or trust instrument, in the discharge or satisfaction, in whole or in part, of a legal obligation of any person is, to the extent so used, taxable to such person as though directly distributed to him as a beneficiary. (See, also, article 167–1.)

The income of an estate of a deceased person, as dealt with in the Act, is therein described as received by the estate during the period of administration or settlement thereof. The period of administration or settlement of the estate is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. If an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. But see

[1] So in original.

sections 42, 43, and 44. As to the taxable gain realized, or the deductible loss sustained, upon the sale or other disposition of property by an administrator, executor, or trustee, and by a legatee, heir, or other beneficiary, see sections 111 and 112. As to capital gains and losses, see section 117. A statutory allowance paid a widow is not deductible from gross income. If real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

The tax upon the net income of the estate or trust shall be paid by the fiduciary (see section 161 (b)). If the tax has been properly paid on the net income of an estate or trust, the net income on which the tax is so paid is not, in the hands of the distributee thereof (the legatee or the beneficiary), taxable as income to him.

Liability for the payment of the tax attaches to the person of the executor or administrator up to and after his discharge if prior to distribution and discharge he had notice of his tax obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed. For the extent of such liability, see section 3467 of the Revised Statutes, as amended by section 518 of the Revenue Act of 1934 (paragraph 48 of the Appendix to these regulations). Liability for the tax also follows the assets of the estate distributed to heirs, devisees, legatees, and distributees, who may be required to discharge the amount of the tax due and unpaid to the extent of the distributive shares received by them. (See section 311.) The same considerations apply to trusts.

SEC. 163. *Credits against net income.*—(a) *Credits of estate or trust.*—(1) For the purpose of the normal tax and the surtax an estate shall be allowed the same personal exemption as is allowed to a single person under section 25 (b) (1), and a trust shall be allowed (in lieu of the personal exemption under section 25 (b) (1)) a credit of $100 against net income.

(2) If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then the estate or trust shall be allowed the same credits against net income for interest as are allowed by section 25 (a).

(b) *Credits of beneficiary.*—If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits against net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of interest specified in section 25 (a) as are, under this Supplement, required to be included in computing his net income. Any remaining portion of such amounts specified in section 25 (a) shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

ART. 163–1. *Credits to estate, trust, or beneficiary—(a) Personal exemption allowed estates and trusts.*—An estate is allowed for both normal tax and surtax purposes the personal exemption of $1,000 allowed a single person under section 25 (b) (1). A trust is allowed for both normal tax and surtax purposes a credit of $100 against net income. A credit for dependents is not allowable to an estate or trust.

(b) *Credit for interest to estate or trust.*—If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, the estate or trust shall be allowed the credits provided in section 25 (a), in respect of interest upon certain obligations of the United States.

(c) *Credit for interest to beneficiary.*—If any part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, he is allowed for the purpose of the normal tax, in addition to his individual credits, the proportionate share of the interest upon obligations of the United States and instrumentalities of the United States which is exempt from normal tax only and is required to be included in computing net income. Any remaining portion of such interest will be allowed as a credit for the purpose of the normal tax to the estate or trust. Where the amount of the interest specified in section 25 (a) is in excess of the net income of the estate or trust, the proportionate share of such interest which each beneficiary is required to include in computing his net income and for which he is allowed a credit for normal tax purposes is an amount equal to his distributive share of the net income of the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income. (See section 25.)

SEC. 164. *Different taxable years.*—If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under section 162 (b), to include in computing his net income, shall be based upon the income of the estate or trust for any taxable year of the estate or trust (whether beginning on, before, or after January 1, 1938) ending within or with his taxable year.

SEC. 165. *Employees' trusts.*—(a) *Exemption from tax.*—A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees—

(1) if contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees,

shall not be taxable under section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of interest specified in section 25 (a).

(b) *Taxable year beginning before January 1, 1939.*—The provisions of clause (2) of subsection (a) shall not apply to a taxable year beginning before January 1, 1939.

ART. 165–1. *Employees' trusts — (a) Plans and trusts for employees.*—A "stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of some or all of his employees" is a definite written program and arrangement signed by such employer and communicated to such employees, solely designed and applied to enable all or a large percentage of the total number of the employer's clerks and workmen (as distinguished from persons in positions of authority) to share in the capital or profits of such employer's trade or business or to provide for the livelihood of such employees upon their retirement from employment. A "trust forming part of a stock bonus, pension, or profit-sharing plan" is a trust formed and availed of solely to aid in the proper execution of one of the plans defined in the preceding sentence. This phrase does not include devices for paying profits or salaries to shareholders or officers, but a trust, applied without discrimination to all the employees and officers of an employer as one group, may be within its meaning.

(b) *Taxable years beginning prior to January 1, 1939.*—A trust forming part of a plan defined in paragraph (a) is exempt for taxable years beginning prior to January 1, 1939, if: (1) contributions are made to the trust by such employer, such employees or both; and (2) such contributions are made for the purpose of distributing to such employees both the earnings and principal of the fund accumulated by the trust; and (3) the fund is accumulated by the trust in accordance with the plan of which the trust is a part.

(c) *Taxable years beginning after December 31, 1938.*—A trust forming part of a plan defined in paragraph (a) is exempt for taxable years beginning after December 31, 1938, if all three tests designated in paragraph (b) as (1), (2), and (3) are met; and if also (4) the trust instrument makes it impossible (in the taxable year and at any time thereafter prior to the satisfaction of all liabilities to employees covered by the trust) for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of such employees.

(d) *Impossibility of diversion.*—As used in section 165 (a) (2), the phrase "if under the trust instrument it is impossible" means that the trust instrument must definitely and affirmatively make it impossible for the non-exempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. It is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the trust, but except as stated

in paragraph (e), it must be impossible for trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees. The diversion of substantial amounts of trust funds from one group of employees to another group of employees is not for the "exclusive" benefit of employees even though both groups were covered by the trust, if the employer (or other non-employee) receives substantial indirect benefit thereby, as, for example, through securing greater loyalty from the favored group, or through the shifting of expected pension benefits to a younger group and the postponement of part of the employer's contributions to a later date. As used in section 165 (a) (2), the phrase "purposes other than for the exclusive benefit of his employees" includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees covered by the trust.

(e) *Meaning of "liabilities."*—The report of the Senate Committee on Finance states that the intent and purpose in section 165 (a) (2) of the phrase "prior to the satisfaction of all liabilities with respect to employees under the trust" is to permit the employer to reserve the right to recover only such balance in the trust at its termination as is "due to erroneous actuarial computations during the previous life of the trust." An "erroneous actuarial computation" means a mistake of an actuarial character reasonably made by a careful person skilled in calculating the amount necessary to satisfy pecuniary obligations depending on the average length of life of a group of individuals, and of such a type that the employer may reserve the right to recover an amount remaining in the trust because of the mistake without conflicting with the purpose for which section 165 (a) (2) was enacted. For example, if a trust created to supply pensions of $25 a month for 10,000 employees for the remainder of their lives after age 60 has been used to supply such pensions only to 500 employees, an amount remaining in the trust for this reason is not due to such a mistake, but to a change in plan; while if $25 a month after age 60 is paid to the 10,000 employees during their lives, but their average duration of life proves less than might reasonably have been expected, an amount remaining in the trust for this reason is due to an "erroneous actuarial computation." Employers might recover more than amounts resulting from such errors if the term "liabilities" included only such obligations to employees as are legally fixed and certain. Hence, the term was used in the Act in its broad common meaning to include both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 700 employees have not yet completed the required period of service, contingent obligations to such 700 employees have nevertheless arisen which constitute "liabilities" within the meaning of that term. It must be impossible for the employer (or other non-employee) to recover other than such amounts as remain in the trust because of "erroneous actuarial computations" after the satisfaction of all such fixed and contingent obligations, and the trust instrument must contain a definite affirmative provision to that effect whether the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and whether such obligations are, technically speaking, liabilties of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

(f) *Portions of years; affiliated corporations.*—Exempt status must be maintained throughout the entire taxable year of the trust in order to obtain any exemption for such year. A trust forming part of a plan of affiliated corporations for their employees may be exempt if all requirements are otherwise satisfied.

(g) *Proof of exemption.*—Every trust claiming exemption must prove its right thereto by filing with the collector: (1) an affidavit showing its character, purpose, activities, sources and disposition of corpus and income, and every fact which might affect its status for exemption, (2) verified copies of the trust instrument and of the employer's plan, showing all amendments, and (3) the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the trust. The financial statement must be filed each year, but the documents mentioned in (1) and (2) need not be filed after the first year except when necessary to show changes occurring since the last filing.

SEC. 166. *Revocable trusts.*—Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

ART. 166–1. *Trusts with respect to the corpus of which the grantor is regarded as remaining in substance the owner.*—(a) *Scope.*—If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) *Test of taxability to grantor.*—Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend, or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: The fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be admin-

istered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstance bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John,

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

If, however, the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

(c) *Income and deductions.*—If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

SEC. 167. *Income for benefit of grantor.*—(a) *Where any part of the income of a trust*—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".

ART. 167–1. *Trusts in the income of which the grantor retains an interest*—(a) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(b) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor. A bare legal interest, such as that of a trustee, is never substantial and never adverse.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal ob-

ligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitely of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(c) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled to had such income been distributable currently to him.

SEC. 168. *Taxes of foreign countries and possessions of United States.*—The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as credit against the tax of the beneficiary of an estate or trust to the extent provided in section 131.

SEC. 169. *Common trust funds.*—(a) *Definitions.*—The term "common trust fund" means a fund maintained by a bank (as defined in section 104)—

(1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; and

(2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks.

(b) *Taxation of common trust funds.*—A common trust fund shall not be subject to taxation under this title, Title IA, or section 105 or 106 of the Revenue Act of 1935, or section 601 or 602 of this Act, and for the purposes of such titles and sections shall not be considered a corporation.

(c) *Income of participants in fund*—(1) *Inclusions in net income.*—Each participant in the common trust fund in computing its net income shall include, whether or not distributed and whether or not distributable—

(A) As a part of its short-tern capital gains or losses, its proportionate share of the net short-term capital gain or loss of the common trust fund;

(B) As a part of its long-term capital gains or losses, its proportionate share of the net long-term capital gain or loss of the common trust fund;

(C) Its proportionate share of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in subsection (d).

(2) *Credit for partially exempt interest.*—The proportionate share of each participant in the amount of interest specified in section 25 (a) received by the common trust fund shall for the purposes of this Supplement be considered as having been received by such participant as such interest.

(d) *Computation of common trust fund income.*—The net income of the common trust fund shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(1) There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed;

(2) After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income;

(3) The so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed.

(e) *Admission and withdrawal.*—No gain or loss shall be realized by the common trust fund by the admission or withdrawal of a participant. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of such interest by the participant.

(f) *Returns by bank.*—Every bank (as defined in section 104) maintaining a common trust fund shall make a return under oath for each taxable year, stating specifically, with respect to such fund, the items of gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the participants who would be entitled to share in the net income if distributed and the amount of the proportionate share of each participant. The return shall be sworn to as in the case of a return filed by the bank under section 52.

(g) *Different taxable years of common trust fund and participant.*—(1) *General rule.*—If the taxable year of the common trust fund is different from that of a participant, the inclusions with respect to the net income of the common trust fund, in computing the net income of the participant for its taxable year shall be based upon the net income of the common trust fund for any taxable year of the common trust fund (whether beginning on, before, or after January 1, 1938) ending within or with the taxable year of the participant.

(2) *Exception.*—If the taxable year of the common trust fund begins before January 1, 1938, and the taxable year of a participant begins after December 31, 1937, the computation of the net income of the common trust fund, and the inclusions with respect to the common trust fund net income, in computing the net income of such participant, shall be made by the method provided in section 169 of the Revenue Act of 1936, and not by the method provided in subsections (c) and (d) of this section.

ART. 169–1. *Common trust fund defined.*—Under section 169 two conditions must be satisfied by a fund maintained by a bank (as defined in section 104) before such fund may be designated as a "common trust fund." These conditions are that such fund must be maintained by such a bank—

(a) Exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank, whether acting alone or in conjunction with one or more co-fiduciaries, but solely in its capacity: (1) as a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court, (2) as an executor of the will of, or as an administrator of the estate of, a deceased person, or (3) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual or of an absent individual and

(b) In conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks, whether or not the bank maintaining such fund is a national bank or a member of the Federal Reserve System.

Except as otherwise provided in this article and articles 169–2 to 169–5, inclusive, the term "participant" refers to any trust or estate, the moneys of which have been contributed to the common trust fund.

ART. 169–2. *Income of participants in common trust fund.*—(a) If the taxable year of a common trust fund begins on or after January 1, 1938, each participant is required to include in computing its net income for its taxable year within which or with which the taxable year of the fund ends, whether or not distributed and whether or not distributable:

(1) Its proportionate share of the net short-term capital gain or loss of the common trust fund, computed as provided in article 169–3, as a part of its short-term capital gains or losses;

(2) Its proportionate share of the net long-term capital gain or loss of the common trust fund, computed as provided in article 169–3, as a part of its long-term capital gains or losses;

(3) Its proportionate share of the ordinary net income or the ordinary net loss of the common trust fund, computed as provided in article 169–3.

(b) Each participant's proportionate share in the amount of interest specified in section 25 (a) received by the common trust fund shall be deemed to have been received by such participant as such interest. For the purposes of the Act, any tax withheld at the source from income of the fund shall be deemed to have been withheld proportionately from the participants to whom such income is allocated.

(c) The proportionate share of each participant in the net short-term capital gain or loss, the net long-term capital gain or loss, the ordinary net income or ordinary net loss, the partially exempt interest, and the tax withheld at the source shall be determined in accordance with the method of accounting adopted by the bank in accordance with the written plan under which the common trust fund is established and administered, provided such method clearly reflects the income of each participant.

The items of income and deductions are, therefore, to be allocated to the periods between valuation dates within the taxable year established by such plan in which they were realized or sustained, and the ordinary net income or ordinary net loss, the net short-term capital gain or loss, and the net long-

term capital gain or loss computed for each such period. The proportionate shares of the participants in such items are then to be determined. The provisions of this paragraph may be illustrated by the following example:

Example: The plan of a common trust fund provides for quarterly valuation dates and for the computation and the distribution of the income upon a quarterly basis, except that there shall be no distribution of capital gains. The participants are as follows: Trusts A, B, C, and D for the first quarter; Trusts A, B, C, and E for the second quarter; and Trusts A, B, F, and G for the third and fourth quarters, the participants having equal participating interests. As computed upon the quarterly basis, the ordinary net income and the short-term capital gain for the taxable year were as follows:

	First quarter	Second quarter	Third quarter	Fourth quarter	Total
Ordinary net income	$200	$300	$200	$400	$1,100
Net short-term capital gain (or loss)	200	[1] 100	200	[1] 100	200

[1] Loss.

The participants' shares of ordinary net income are as follows:

Participants' Shares of Ordinary Net Income

Participant	First quarter	Second quarter	Third quarter	Fourth quarter	Total
A	$50	$75	$50	$100	$275
B	50	75	50	100	275
C	50	75			125
D	50				50
E		75			75
F			50	100	150
G			50	100	150
Total	200	300	200	400	1,100

The participants' shares of net short-term capital gain or loss are as follows:

Participants' Shares of Net Short-Term Capital Gain (or Loss)

Participant	First quarter	Second quarter	Third quarter	Fourth quarter	Total
A	$50	[1] $25	$50	[1] $25	$50
B	50	[1] 25	50	[1] 25	50
C	50	[1] 25			25
D	50				50
E		[1] 25			[1] 25
F			50	[1] 25	25
G			50	[1] 25	25
Total	200	[1] 100	200	[1] 100	200

[1] Loss.

If in the above example the common trust fund also had long-term capital gains or losses, the treatment of such gains or losses would be similar to that accorded to the short-term capital gains and losses.

(*d*) The provisions of sections 161, 162, 166, and 167 are applicable in determining the extent to which each participant's proportionate share of the income of the common trust fund is taxable to the participant, or to the beneficiaries or the grantor of the participant.

(*e*) If the taxable year of the common trust fund begins before January 1, 1938, each participant is required to include in its gross income for its taxable year (even though beginning after December 31, 1937) within which or with which the taxable year of the fund ends, its proportionate share of the net income (computed in accordance with the provisions of section 169 of the Revenue Act of 1936).

ART. 169–3. *Computation of common trust fund income.*—The net income of the common trust fund shall be computed in the same manner and on the same basis as in the case of an individual, except that:

(1) No deduction shall be allowed under section 23 (o) for charitable contributions.

(2) The short-term capital gains and losses of the common trust fund and its long-term capital gains and losses are required to be segregated and the computation made of the net short-term capital gain or loss and the net long-term gain or loss, as the case may be. A common trust fund is not allowed the benefit of the net short-term capital loss carry-over provided by section 117 (e).

(3) The ordinary net income, that is, the excess of the gross income over the deductions, or the ordinary net loss, that is, the excess of the deductions over the gross income, shall be computed after excluding all items of either short-term or long-term capital gain or loss.

ART. 169–4. *Admission and withdrawal of participants from the common trust fund—(a) Gain or loss.*—The common trust fund realizes no gain or loss by the admission or withdrawal of a participant, and the basis of the assets and the period for which they are deemed to have been held by the common trust fund for the purposes of section 117 (b) are unaffected by such an admission or withdrawal. If a participant withdraws the whole or any part of its participating interest from the common trust fund, such withdrawal shall be treated as a sale or exchange by the participant of the participating interest or portion thereof which is so withdrawn. A participant is not deemed to have withdrawn any part of its participating interest in the common trust fund so as to have completed a closed transaction by reason of the segregation and administration of an investment of the fund, pursuant to the provisions of subdivision (c) (7) of section 17 of Regulation F of the Board of Governors of the Federal Reserve System, effective December 31, 1937, for the benefit of all the then participants in the common trust fund. (See paragraphs 27–30 of the Appendix to these regulations.) Such segregated investments shall be considered as held by, or on behalf of, the common trust fund for the benefit ratably of all participants in the common trust fund at the time of segregation, and any income or loss arising from its administration and liquidation shall constitute income or loss to the common trust fund apportionable among the participants for whose benefit the investment was segregated.

(*b*) *Basis for gain or loss upon withdrawal.*—The participant's gain or loss upon withdrawal of its participating interest or portion thereof shall be measured by the difference between the amount received upon such withdrawal and the basis of the participating interest or portion thereof withdrawn (with proper adjustments as provided in section 113 (b) to the date of withdrawal) plus the additions prescribed in paragraph (*c*) of this article and minus the reductions prescribed in paragraph (*d*) of this article. The amount received by the participant shall be the sum of any money plus the fair market value of property (other than money) received upon such withdrawal. The basis of the participating interest or portion thereof withdrawn shall be the money contributed by the participant to the common trust fund to acquire the participating interest or portion thereof withdrawn. Such basis shall not be reduced on account of the segregation of any investment in the common trust fund pursuant to the provisions of subdivision (c) (7) of section 17 of Regulation F of the Board of Governors of the Federal Reserve System, effective December 31, 1937. For the purpose of making the adjustments, additions, and reductions with respect to basis as prescribed in this paragraph, the ward, rather than the guardian, shall be deemed to be the participant; and the grantor, rather than the trust to the extent that the income of the trust is taxable to the grantor pursuant to the provisions of section 166 or 167, shall be deemed to be the participant.

(*c*) *Additions to basis.*—As prescribed in paragraph (*b*) of this article, in computing the gain or loss upon the withdrawal of a participating interest or portion thereof, there shall be added to the basis of the participating interest or portion thereof withdrawn an amount equal to the aggregate of the following items, to the extent that they were properly allocated to the participant for a taxable year of the common trust fund, and were not distributed to the participant prior to withdrawal:

(1) wholly exempt income of the common trust fund for any taxable year,

(2) net income of the common trust fund for the taxable years beginning

after December 31, 1935 and prior to January 1, 1938,

(3) net short-term capital gain of the common trust fund for each taxable year beginning on or after January 1, 1938,

(4) the excess of the gains over the losses recognized to the common trust fund for each taxable year beginning on or after January 1, 1938, upon sales or exchanges of capital assets held for more than 18 months, and

(5) ordinary net income of the common trust fund for each taxable year beginning on or after January 1, 1938.

(d) *Reductions in basis.*—As prescribed in paragraph (b) of this article, in computing the gain or loss upon the withdrawal of a participating interest or portion thereof, the basis of the participating interest or portion thereof withdrawn shall be reduced by such portions of the following items as were allocable to the participant with respect to the participating interest or portion thereof withdrawn:

(1) the amount of the excess of the allowable deductions of the common trust fund over its gross income for the taxable years beginning after December 31, 1935, and prior to January 1, 1938, and

(2) the amount of the net short-term capital loss, net long-term capital loss and ordinary net loss of the common trust fund for each taxable year beginning on or after January 1, 1938.

ART. 169–5. *Returns of common trust funds.*—A bank maintaining a common trust fund shall make a return of income of the common trust fund, regardless of the amount of its net income. If a bank maintains more than one common trust fund, a separate return shall be made for each. The return shall be made for the taxable year of the common trust fund on the form prescribed by the Commissioner, in accordance with these regulations and the instructions on the form or issued therewith. The return of a common trust fund shall state specifically with respect to the fund the items of gross income and the deductions allowed under Title I, and shall include each participant's name and address and its proportionate share of the net short-term capital gain or loss, the net long-term capital gain or loss, and the ordinary net income or loss. See article 169–2. A copy of the plan of the common trust fund must be filed with the return. If, however, a copy of such plan has once been filed with a return, it need not again be filed if the return contains a statement showing when and where it was filed. If the plan is amended in any way after such copy has been filed, a copy of the amendment must be filed with the return for the taxable year in which the amendment was made. Each such return shall be sworn to in the same manner as the return filed by the bank under section 52.

CHAPTER XXIV

Partnerships

Supplement F—Partnerships

SEC. 181. *Partnership not taxable.*—Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

ART. 181–1. *Partnerships.*—Partnerships as such are not subject to taxation under the Act, but are required to make returns of income. (See sections 187 and 188.) For definition of what the term "partnership" includes, see section 901 (a) (3).

SEC. 182. *Tax of partners.*

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

ART. 182–1. *Distributive share of partners.*—(a) If the taxable year of the partnership begins on or after January 1, 1938, each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

(1) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(2) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(b) If the taxable year of the partnership begins before January 1, 1938, each partner is required to include in his return for his taxable year (even though beginning after December 31, 1937) within which or with which the taxable year of the partnership ends, his distributive share, whether or not distributed, of the net income of the partnership as determined by the method provided in sections 182 and 183 of the Revenue Act of 1936. See section 188 of the Revenue Act of 1938.

(c) If separate returns are made by the husband and wife domiciled in a community property State, and the husband only is a member of a partnership, the part of his distributive share of the partnership's net short-term capital gain or loss, net long-term capital gain or loss, or ordinary net income or ordinary net loss, which is, or is derived from, community property, should be reported by the husband and by the wife in equal proportions. In the case of a partnership closely related to other trades or businesses, see section 45.

SEC. 183. *Computation of partnership income.*—(a) *General rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) *Segregation of items.*—(1) Capital gains and losses.—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) Ordinary net income or loss.—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable contributions.*—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

ART. 183–1. *Computation of partnership income.*—The net income of the partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that:

(1) The partnership is required to segregate its short-term capital gains and losses and its long-term capital gains and losses and to compute the net short-term capital gain or loss and the net long-term capital gain or loss, as the case may be. A partnership is not allowed the benefit of the net short-term capital loss carry-over provided by section 117 (e).

(2) The partnership is further required, after excluding all items of either short-term or long-term capital gain or loss, to compute (a) an ordinary net income which consists of the excess of the gross income over the deductions, or (b) an ordinary net loss which consists of the excess of the deductions over the gross income. In the computation of its ordinary net income or ordinary net loss, the partnership is denied the so-called charitable contribution deduction allowed by section 23 (o), but each partner is considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of a character which would be allowed to the partnership as a deduction if section 183 (c) had not been enacted. Payments made to a partner for services rendered and for interest on capital contributions are not deductible in computing the net income of the partnership, such payments being held to represent a division of partnership profits.

SEC. 184. *Credits against net income.*—The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership.

ART. 184–1. *Credits allowed partners.*—The credits against net income provided in section 25 are not applicable to partnerships as such. An individual partner, however, is entitled for the purpose of the normal tax to a credit against his net income, in addition to the credits allowed to him under section 25, of his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. There shall be included in the return of the partnership a statement of the amounts of such interest and the proportionate share thereof of each partner.

SEC. 185. *Earned income.*—In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership.

ART. 185–1. *Earned income credit of partners.*—For the purpose of computing the earned income credit against net income (see section 25 (a) (3) and (4)), a member of a partnership is entitled to treat a proper part of his distributive share of the partnership net income as earned income. Such part cannot exceed a reasonable allowance as compensation for personal services actually rendered by the partner in connection with the partnership business. In the case of a partnership which is engaged in a trade or business in which capital is a material income-producing factor and in the trade or business of which the partner renders personal services which are material to the earning of the partnership income, the earned income of the partner from the partnership is a reasonable allowance as compensation for the personal services actually rendered by him, but not in excess of 20 percent of his share of the net profits of the partnership (computed without deduction for so-called salaries to members). In such a case, if reasonable compensation is less than 20 percent of the partner's share of the net profits, the earned income is the full amount of the reasonable compensation, but, if reasonable compensation is more than 20 percent of the partner's share of the net profits, then the earned income is 20 percent of the partner's share of such profits.

There must be included in the return of the partnership a statement showing the names of the members and the amount (determined in accordance with the first paragraph of this article) of each partner's distributive share of the partnership net income which consists of earned income.

Example: A partnership composed of A, B, and C is engaged in the retail men's clothing business. Each partner is entitled to one-third of the net profits, after deduction of so-called salaries to members. A devotes most of his time to the business and is paid a salary of $10,000. B devotes half of his time to the business and is paid a salary of $5,000. C devotes none of his time to the business and receives no salary. The net profits of the partnership for the taxable year, computed without deduction for so-called salaries to members, are $24,000. The earned income of the partners from the partnership is as follows: Although A received a salary of $10,000 and B a salary of $5,000, since the partnership is engaged in a business in which capital is a material income-producing factor, the earned income of each from the partnership is limited to 20 percent of his share of the net profits. A's share of the net profits is $13,000 ($10,000 (salary) + $3,000 (⅓ of net profits after deduction of $15,000 for salaries)). Twenty percent of $13,000 is $2,600, to which amount A's earned income from the partnership is limited. Since B's share of the net profits is $8,000 ($5,000+$3,000), 20 percent thereof, or $1,600, is B's earned income from the partnership. C has no earned income from the partnership, since he renders no personal services in connection with the partnership business.

SEC. 186. *Taxes of foreign countries and possessions of United States.*—The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 187. *Partnership returns.*—Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

ART. 187–1. *Partnership returns.*—Every partnership shall make a return of income, regardless of the amount of its net income (see section 901 (a) (3) defining the term "partnership"). The return shall be on Form 1065; shall state specifically the information required to be stated by the return form; shall be filled in according to the instructions contained thereon or issued with respect thereto; and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership, that is, for its annual accounting period (fiscal year or calendar year, as the case may be), irrespective of the taxable years of the partners. (See sections 182 and 183.) If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 47.

SEC. 188. *Different taxable years of partner and partnership*—(a) *General rule.*—If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1938) ending within or with the taxable year of the partner.

(b) *Partnership year beginning in 1937.*—If the taxable year of the partnership begins before January 1, 1938, and the taxable year of a partner begins after December 31, 1937, the computation of the net income of the partnership, and the inclusions with respect to the partnership net income, in computing the net income of such partner, shall be made by the method provided in sections 182 and 183 of the Revenue Act of 1936 and not by the method provided in sections 182 and 183 of this Act.

CHAPTER XXV

Insurance Companies

Supplement G—Insurance Companies

SEC. 201. *Tax on life insurance companies*—(a) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

ART. 201 (a)–1. *Life insurance companies: Definition.*—The term "life insurance company" as used in Title I is defined in section 201 (a). In determining whether an insurance company is a "life insurance company" as defined in section 201 (a), no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of "reserve" contained in article 203 (a) (2)–1.

[SEC. 201. *Tax on life insurance companies.*]

(b) *Imposition of tax.*—(1) *In general.*—In lieu of the tax imposed by sections 13 and 14, there shall be levied, collected, and paid for each taxable year upon the special class net income of every life insurance company a tax of 16½ per centum of the amount thereof.

(2) *Special class net income of foreign life insurance companies.*—In the case of a foreign life insurance company, the special class net income shall be an amount which bears the same ratio to the special class net income, computed without regard to this paragraph, as the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States bear to the reserve funds held by it at the end of the taxable year upon all business transacted.

(3) *No United States insurance business.*—Foreign life insurance companies not carrying on an insurance business within the United States and holding no reserve funds upon business transacted within the United States, shall not be taxable under this section but shall be taxable as other foreign corporations.

ART. 201 (b)–1. *Life insurance companies: Rate of tax.*—Life insurance companies are subject to the tax imposed by section 201 (b), in lieu of the tax imposed by sections 13 and 14. The rate is 16½ percent, and the tax is imposed

upon the special class net income as defined in section 14. The net income of life insurance companies differs from the net income of other corporations. Life insurance companies are entitled to the credits provided in section 26 (a) and (b) and are not subject to the provisions of section 117 (capital gains and losses).

All provisions of the Act and of these regulations not inconsistent with the specific provisions of sections 201–203 are applicable to the assessment and collection of the tax imposed by section 201 (b), and life insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120L.

ART. 201 (b)–2. *Foreign life insurance companies: Net income.*—The special class net income of a foreign life insurance company carrying on an insurance business within the United States or holding reserve funds upon business transacted within the United States consists of that proportion of its net income from all sources, within and without the United States, computed under the provisions of sections 202 and 203 minus the credits provided in section 26 (a) and (b), which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States bear to the reserve funds held by it at the end of the taxable year upon all business transacted. Other foreign life insurance companies are not taxable under section 201 (b), but are taxable the same as other foreign corporations. See section 231.

SEC. 202. *Gross income of life insurance companies.*—(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents. For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

SEC. 203. *Net income of life insurance companies.*—(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

ART. 203 (a)–1. *Limitation on deductions.*—In addition to the limitations on deductions hereinafter specifically referred to, life insurance companies are subject to the limitation provided in section 24 (a) (5).

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(1) *Tax-free interest.*—The amount of interest received during the taxable year which under section 22 (b) (4) is excluded from gross income;

ART. 203 (a) (1)–1. *Tax-free interest.*—Interest which in the case of other taxpayers is excluded from gross income by section 22 (b) (4) but included in the gross income of a life insurance company by section 202 (a) is allowed as a deduction from gross income by section 203 (a) (1).

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(2) *Reserve funds.*—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

ART. 203 (a) (2)–1. *Reserve funds.*—In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ percent of the mean of such reserve funds held at the beginning and end of the taxable year.

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(3) *Reserve for dividends.*—An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(4) *Investment expenses.*—Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

ART. 203 (a) (4)–1. *Investment expenses.*—The term "general expenses" as used in the Act means any expense incurred for the benefit of more than one department of the company rather than for the benefit of a particular department thereof. Any assignment of such expense to the investment department of the company for which a deduction is claimed under section 203 (a) (4) shall operate to subject the total investment expenses to the limitation provided in that section.

If no general expenses are assigned to or included in investment expenses the deduction may consist of investment expenses actually paid during the taxable year in which case an itemized schedule of such expenses must be appended to the return.

Invested assets for the purpose of section 203 (a) (4) and this article are those which are owned and used, and to the extent used, for the purpose of producing the income specified in section 202 (a).

The maximum allowance of one-fourth of 1 percent will not be granted unless it

is shown to the satisfaction of the Commissioner that such allowance is justified.

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(5) *Real estate expenses.*—Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

ART. 203 (a) (5)–1. *Taxes and expenses with respect to real estate.*—The deduction for taxes and expenses under section 203 (a) (5) includes taxes and expenses paid during the taxable year exclusively upon or with respect to real estate owned by the company and any sum representing taxes imposed upon a shareholder of the company upon his interest as shareholder which is paid by the company without reimbursement from the shareholders. No deduction shall be allowed, however, for taxes, expenses, and depreciation upon or with respect to any real estate owned by the company except to the extent used for the purpose of producing investment income. (See article 203 (a) (4)–1.) As to real estate owned and occupied by the company see article 203 (b)–1.

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(6) *Depreciation.*—A reasonable allowance, as provided in section 23 (l), for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence; and

ART. 203 (a) (6)–1. *Depreciation.*—The deduction allowed by section 203 (a) (6) for depreciation is, except as provided in article 203 (b)–1, identified with that allowed other corporations by section 23 (l). The amount allowed by section 23 (l) in the case of life insurance companies is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 202 (a).

[SEC. 203. *Net income of life insurance companies.*]

[(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—]

(7) *Interest.*—All interest paid within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

ART. 203 (a) (7)–1. *Interest.*—The deduction allowed by section 203 (a) (7) for interest on indebtedness is the same as that allowed other corporations by section 23 (b) but this deduction includes interest on dividends held on deposit and surrendered during the taxable year. Reserve funds as defined in article 203 (a) (2)–1 are not indebtedness. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

If a life insurance company pays interest on the proceeds of life insurance policies left with it pursuant to the provisions of supplementary contracts, not involving life contingencies, or similar contracts, the interest so paid shall be allowed as a deduction from gross income, except that such deduction shall not be allowed in respect of interest accrued in any prior taxable year to the extent that the company has had the benefit of a deduction of 4 percent or 3¾ percent, as the case may be, of the mean of the company's liability on such contracts, by the inclusion of such liability in its reserve funds.

[SEC. 203. *Net income of life insurance companies.*]

(b) *Rental value of real estate.*—The deduction under subsection (a) (5) or (6) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

ART. 203 (b)–1. *Real estate owned and occupied.*—The amount allowable as a deduction for taxes, expenses, and depreciation upon or with respect to any real estate owned and occupied in whole or in part by a life insurance company is limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the space not so occupied bears to the rental value of the entire property. For example, if the rental value of the space not occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property. Where a deduction is claimed as provided in this article, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

SEC. 204. *Insurance companies other than life or mutual.*—(a) *Imposition of tax.*—(1) *In general.*—In lieu of the tax imposed by sections 13 and 14, there shall be levied, collected, and paid for each taxable year upon the special class net income of every insurance company (other than a life or mutual insurance company) a tax of 16½ per centum of the amount thereof.

(2) *Special class net income of foreign companies.*—In the case of a foreign insurance company (other than a life or mutual insurance company), the special class net income shall be the net income from sources within the United States minus the sum of—

(A) *Interest on obligations of the United States and its instrumentalities.*—The credit provided in section 26 (a).

(B) *Dividends received.*—The credit provided in section 26 (b).

(3) *No United States insurance business.*—Foreign insurance companies not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.

ART. 204 (a)–1. *Tax on insurance companies other than life or mutual.*—All insurance companies (other than life or mutual companies or foreign insurance companies not carrying on an insurance business within the United States) are subject to the tax imposed by section 204. The term "insurance companies" as used in this article and in articles 204 (b)–1 and 204 (c)–1 means only those companies subject to the tax imposed by section 204. The rate of the tax imposed by section 204 is 16½ percent and the tax is imposed upon the special class net income as defined in section 14. The net income of insurance companies other than life or mutual is defined in section 204 and differs from the net income of other corporations. All provisions of the Act and of these regulations not inconsistent with the specific provisions of section 204 are applicable to the assessment and collection of the tax imposed by section 204 (a), and insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. Since section 204 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 204 will be for the taxable year ending December 31, 1938, and shall be on Form 1120. Insurance companies are entitled to the credits provided in section 26 (a) and (b).

Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 204 but are taxable as other foreign corporations. See section 231.

[SEC. 204. *Insurance companies other than life or mutual.*]

(b) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22;

(2) *Net income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment income.*—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end

of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year:

(4) *Underwriting income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) *Premiums earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) *Losses incurred.*—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) *Expenses incurred.*—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

ART. 204 (b)-1. *Gross income of insurance companies other than life or mutual.*—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, and all other items constituting gross income under section 22. See section 22 (a), (b), and (c) and sections 28 and 334. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from home office of a foreign insurance company to the United States branch, borrowed money, gross increase due to adjustments in book value of capital assets, and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Act will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits, are ignored. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts or, having been previously charged off, are recovered during the taxable year.

[SEC. 204. *Insurance companies other than life or mutual.*]

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Subject to the limitation contained in section 117 (d), losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount of interest earned during the taxable year which under section 22 (b) (4) is excluded from gross income;

(8) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l);

(9) Charitable, and so forth, contributions, as provided in section 23 (q);

(10) Deductions (other than those specified in this subsection) as provided in section 23, but not in excess of the amount of the gross income included under subsection (b) (1) (C) of this section.

(d) *Deductions of foreign corporations.*—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein.

(e) *Double deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

ART. 204 (c)-1. *Deductions allowed insurance companies other than life or mutual.*—The deductions allowable are specified in section 204, but are subject to the limitation provided in section 24 (a) (5).

Among the items which may not be deducted are income and profits taxes imposed by the United States, income and profits taxes imposed by any foreign country or possession of the United States (in cases where the company signifies in its return its desire to claim to any extent a credit for such taxes), taxes assessed against local benefits, donations, decrease during the year due to adjustments in the book value of capital assets, decrease in liabilities during the year on account of reinsurance treaties, dividends paid to shareholders, remittances to the home office of a foreign insurance company by the United States branch, and borrowed money repaid.

In computing net income of insurance companies other than life or mutual losses sustained during the taxable year from the sale or other disposition of property are deductible subject to the limitation contained in section 117 (d) but the graduated percentage reduction of gains and losses contained in section 117 (b) does not apply in the case of insurance (or other) corporations. Insurance companies conducting their business in such manner as to receive income under section 204 (b) (1) (C) are entitled to such deductions relating thereto as are provided for in section 204 (c), but, in the case of deductions referred to in section 204 (c) (10), only to the extent that the aggregate amount thereof does not exceed the income included under section 204 (b) (1) (C).

SEC. 205. *Taxes of foreign countries and possessions of United States.*—The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 201, 204, or 207, to the extent provided in the case of a domestic corporation in section 131, and in the case of the tax imposed by section 201 or 204 "net income" as used in section 131 means the net income as defined in this Supplement.

SEC. 206. *Computation of gross income.*—The gross income of insurance companies subject to the tax imposed by section 201 or 204 shall not be determined in the manner provided in section 119.

SEC. 207. *Mutual insurance companies other than life.*—(a) *Imposition of tax.*—

(1) *In general.*—There shall be levied, collected, and paid for each taxable year upon the special class net income of every mutual insurance company (other than a life insurance company) a tax equal to 16½ per centum thereof.

(2) *Foreign corporations.*—The tax imposed by paragraph (1) shall apply to foreign corporations as well as domestic corporations; but foreign insurance companies not carrying on an insurance business within the United States shall be taxable as other foreign corporations.

(b) *Gross income.*—Mutual marine-insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual insurance companies other than life insurance.*—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) *Mutual marine insurance companies.*—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) *Mutual insurance companies other than life and marine.*—In the case of mu-

tual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

ART. 207–1. *Tax on mutual insurance companies other than life.*—All mutual insurance companies other than life (including foreign insurance companies carrying on an insurance business within the United States) are subject to the tax imposed by section 207 and the rate of tax is 16½ percent. The tax is imposed upon the special class net income as defined in section 14. The net income of mutual insurance companies differs from the net income of other corporations.

Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 207 but are taxable as other foreign corporations. See section 231.

ART. 207–3. *Gross income of mutual insurance companies other than life.*—The gross income of mutual insurance companies (other than life) consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the Act. Gross income includes net premiums (that is, gross premiums less returned premiums on policies canceled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by mutual fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as is not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that such funds are released to the general uses of the company and increase its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established.

ART. 207–3. *Deductions allowed mutual insurance companies other than life insurance companies.*—Mutual insurance companies (other than life insurance companies) are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. Mutual insurance companies are not entitled to the deductions allowed by section 204 (c), but (except in the case of life insurance companies) are entitled to the deductions allowed by section 23. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year.

ART. 207–4. *Required addition to reserve funds of mutual insurance companies (other than life).*—Mutual insurance companies, other than life insurance companies, may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds "required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. For a general definition of "reserve fund" see article 203 (a) (2)–1. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guarantee surplus" fund or similar fund. In the case of foreign insurance companies the deductions provided for by section 207 shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein.

ART. 207–5. *Special deductions allowed mutual marine insurance companies.*—Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly forms part of the net income of the company, except to the extent that it is subject to the deductions allowed such insurance companies and other corporations.

ART. 207–6. *Special deductions allowed mutual insurance companies (other than life or marine).*—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment cannot be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

ART. 207–7. *Returns of mutual insurance companies (other than life).*—Mutual insurance companies other than life (including foreign insurance companies carrying on an insurance business within the United States) are required to file returns of income. The return shall be on Form 1120. As an aid in auditing the returns, wherever possible a copy of the report to the State insurance department should be submitted with the return. Otherwise a copy of Schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the Federal, State, and municipal obligations from which the interest omitted from

gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing. All provisions of the Act and these regulations not inconsistent with the specific provisions of section 207 are applicable to the assessment and collection of the tax imposed by section 207, and mutual insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations.

CHAPTER XXVI

Nonresident Aliens

Supplement H—Nonresident Alien Individuals

SEC. 211 *Tax on nonresident alien individuals.*—(a) *No United States business or office.*—(1) *General rule.*—There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, a tax of 10 per centum of such amount, except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate (not less than 5 per centum) as may be, provided by treaty with such country. For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(2) *Aggregate more than $21,600.*—The tax imposed by paragraph (1) shall not apply to any individual if the aggregate amount received during the taxable year from the sources therein specified is more than $21,600.

(3) *Residents of contiguous countries.*—Despite the provisions of paragraph (2), the provisions of paragraph (1) shall apply to a resident of a contiguous country so long as there is in effect a treaty with such country (ratified prior to August 26, 1937) under which the rate of tax under section 211 (a) of the Revenue Act of 1936, prior to its amendment by section 501 (a) of the Revenue Act of 1937, was reduced.

(b) *United States business or office.*—A nonresident alien individual engaged in trade or business in the United States or having an office or place of business therein shall be taxable without regard to the provisions of subsection (a). As used in this section, section 119, section 143, section 144, and section 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian.

(c) *No United States business or office and gross income of more than $21,600.*—A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein who has a gross income for any taxable year of more than $21,600 from the sources specified in subsection (a) (1), shall be taxable without regard to the provisions of subsection (a) (1), except that—

(1) The gross income shall include only income from the sources specified in subsection (a) (1);

(2) The deductions (other than the so-called "charitable deduction" provided in section 213 (c)) shall be allowed only if and to the extent that they are properly allocable to the gross income from the sources specified in subsection (a) (1);

(3) The aggregate of the normal tax and surtax under sections 11 and 12 shall, in no case, be less than 10 per centum of the gross income from the sources specified in subsection (a) (1); and

(4) This subsection shall not apply to a resident of a contiguous country so long as there is in effect a treaty with such country (ratified prior to August 26, 1937) under which the rate of tax under section 211 (a) of the Revenue Act of 1936, prior to its amendment by section 501 (a) of the Revenue Act of 1937, was reduced.

ART. 211–1. *Taxation of aliens in general.*—For the purposes of the Act alien individuals are divided generally into two classes, namely, resident aliens and nonresident aliens. Resident aliens are in general taxable the same as citizens of the United States, that is, a resident alien is taxable on income derived from all sources including sources without the United States. Nonresident aliens are taxable only on income from sources within the United States. For classification of nonresident aliens, see article 211–7.

ART. 211–2. *Definition.*—A "nonresident alien individual" means an individual—

(*a*) Whose residence is not within the United States; and

(*b*) Who is not a citizen of the United States.

The term includes a nonresident alien fiduciary.

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abondoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this article, in the absence of exceptional circumstances.

ART. 211–3. *Alien seamen, when to be regarded as residents.*—In order to determine whether an alien seaman is a resident within the meaning of the income tax law, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established a residence in the United States. Residence may be established on a vessel regularly engaged in coastwise trade, but the mere fact that a sailor makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the United States within the rules laid down in article 211–4, although the nature of his calling requires him to be absent for a long period from the place where his residence is established. An alien seaman may acquire such a residence at a sailors' boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide. The filing of Form 1078 or taking out first citizenship papers is proof of residence in the United States from the time the form is filed or the papers taken out, unless rebutted by other evidence showing an intention to be a transient. The fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country.

ART. 211–4. *Proof of residence of alien.*—The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of the Act. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overcome—

(1) In the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (*a*) proof that the alien, at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident;

(2) In other cases by (*a*) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien has filed Form 1078 or its equivalent, or (*c*) proof

of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.

In any case in which an alien seeks to overcome the presumption of nonresidence under (1) (c) or (2) (c), if the internal-revenue officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits.

ART. 211–5. *Loss of residence by alien.*—An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States.

ART. 211–6. *Duty of employer to determine status of alien employee.*—If wages are paid to aliens without withholding the tax, except as permitted in article 143–3, in the case of a resident of Canada or Mexico, the employer should be prepared to prove the status of the alien as provided in the foregoing articles. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078, or an equivalent certificate of the alien establishing residence. An employer need not secure Form 1078 from the alien if he is satisfied that the alien is a resident alien. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1078 or its equivalent, is permitted to prove the former status of the alien by any competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

ART. 211–7. *Taxation of nonresident alien individuals.*—For the purposes of this article and articles 212–1, 213–1, 214–1, and 217–2, nonresident alien individuals are divided into three classes: (1) nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year and deriving in the taxable year not more than $21,600 gross amount of fixed or determinable annual or periodical income from sources within the United States; (2) nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year and deriving in the taxable year more than $21,600 gross amount of fixed or determinable annual or periodical income from sources within the United States; and (3) nonresident alien individuals who at any time during the taxable year are engaged in trade or business in the United States or have an office or place of business therein.

(a) *No United States business or office—General rule.*—A nonresident alien individual within class (1) referred to in the preceding paragraph is liable to the tax upon the amount received from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income. For the purposes of section 211 (a), the term "amount received" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Act as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensation, remunerations, and emoluments, but other fixed or determinable annual or periodical gains, profits, and income are also subject to the tax, as, for instance, royalties. As to the determination of fixed or determinable annual or periodical income, see article 143–2. The items of fixed or determinable annual or periodical income from sources within the United States received by a citizen of France residing in France which are exempt from Federal income taxation under the provisions of the tax convention between the United States and France signed April 27, 1932, and effective January 1, 1936 (see page 680 of the Appendix to these regulations), are described in article 143–3.

The fixed or determinable annual or periodical income from sources within the United States of a nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year and deriving in the taxable year not more than $21,600 gross amount of fixed or determinable annual or periodical income from sources within the United States, is taxable at the rate of 10 percent, except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate (not less than 5 percent) as may be provided by treaty with such country. (See also article 212–1.) Under the terms of the tax convention between the United States and Canada, signed December 30, 1936, and effective January 1, 1936, the tax at the rate of 10 percent imposed by section 211 (a) is reduced to 5 percent in the case of a nonresident alien individual who is a resident of Canada. (See page 668 of the Appendix to these regulations.)

(b) *No United States business or office.—Aggregate more than $21,600.*—A nonresident alien individual within class (2) referred to in the first paragraph of this article is, under the provisions of section 211 (c), subject to tax only upon his fixed or determinable annual or periodical income specified in section 211 (a) determined under the provisions of section 119, minus (1) the deductions properly allocable to such income and (2) the so-called "charitable contributions" deduction provided in section 213 (c). Such nonresident alien is entitled to the credits against net income allowable to an individual by section 25, subject to the limitations provided in section 214. However, the tax thus computed under sections 11 and 12 shall in no such case be less than 10 percent of the gross amount of such fixed or determinable annual or periodical income from sources within the United States. Nonresident alien individuals, residents of Canada, are not affected by the provisions of section 211 (c) or of this paragraph but are (under the terms of the tax convention between the United States and Canada) subject to tax under the provisions of section 211 (a) and the special provisions of paragraph (a) of this article relating to such aliens.

(c) *United States business or office.*—A nonresident alien individual within class (3), referred to in the first paragraph of this article, is not taxable at the rate of 10 percent upon the items of gross income enumerated in section 211 (a). The net income from sources within the United States of such a nonresident alien individual (gross income from sources within the United States minus the statutory deductions provided in sections 23 and 213) less the credits against net income allowable to an individual by section 25, is subject to the normal tax of 4 percent imposed by section 11 and the graduated surtax imposed by section 12 (b).

As used in sections 211, 119, 143, 144, and 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation not engaged in trade or business within the United States by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian. (See also article 212–1.)

Whether a nonresident alien has an "office or place of business" within the United States depends upon the facts in a particular case. The term "office or place of business," however, implies a place for the regular transaction of business and does not include a place where casual or incidental transactions might be, or are, effected.

Neither the beneficiary nor the grantor of a trust, whether revocable or irrevocable, is deemed to be engaged in trade or business in the United States or to have an office or place of business therein, merely because the trustee is engaged in trade or business in the United States or has an office or place of business therein.

SEC. 212. *Gross income.*—(a) *General rule.*—In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

(b) *Ships under foreign flag.*—The income of a nonresident alien individual which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States shall not be included in gross income and shall be exempt from taxation under this title.

ART. 212–1. *Gross income of nonresident individuals.*—In general, in the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States, determined under the provisions of section 119. (See articles 119–1 to 119–14.) The items of gross income from sources without the United States and therefore not taxable to nonresident aliens are described in section 119 (c). As to who are nonresident alien individuals see articles 211–2 to 211–6.

Income received by a resident alien from sources without the United States is taxable although such person may become a nonresident alien subsequent to its receipt and prior to the close of the taxable year. Conversely, income received by a nonresident alien from sources without the United States is not taxable though such person may become a resident alien subsequent to its receipt and prior to the close of the taxable year.

(a) *No United States business or office.*—The gross income of a nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year, whether such alien comes within section 211 (a) or section 211 (c), is gross income from sources within the United States consisting of fixed or determinable annual or periodical income. His taxable income does not include profits derived from the effecting of transactions in the United States in stocks, securities or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein.

(b) *United States business or office.*—The gross income of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States or had an office or place of business therein is not limited to the items of gross income specified in section 211 (a), but includes any item of gross income which is treated as income from sources within the United States, except those items which are exempt from taxation by statute or treaty or which are not taxable by the Federal Government under the Constitution. (See sections 22 (b), 112, 116, 119, and 212 (b).)

In general, any nonresident alien individual who performs personal services within the United States is considered as being engaged in trade or business within the United States and therefore his net income from sources within the United States, including his compensation, is subject to the normal tax of 4 percent and the surtax. However, the phrase "engaged in trade or business within the United States" does not apply to the personal services performed within the United States for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such compensation is not income from sources within the United States. (See section 119 (a) (3).) As to the exclusion from gross income of the official compensation received by employees of foreign governments see section 116 (h).

The effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian does not bring a nonresident alien individual within the class of nonresident alien individuals engaged in trade or business within the United States, but if a nonresident alien individual by reason of rendering personal services in the United States, or for other reasons, is classed as a nonresident alien individual engaged in trade or business within the United States or having an office or place of business therein, he is taxable upon all income from sources within the United States, including profits derived from the effecting of such transactions. Such a nonresident alien individual is required to include in gross income capital gains, gains from hedging transactions, and profits derived from the sale within the United States of personal property, or of real property located therein.

ART. 212–2. *Exclusion of earnings of foreign ships from gross income.*—So much of the income from sources within the United States of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States, or had an office or place of business therein as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in such foreign country and to corporations organized in the United States, shall not be included in gross income. Foreign countries which either impose no income tax, or, in imposing such tax, exempt from taxation so much of the income of a citizen of the United States nonresident in such foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States are considered as granting an equivalent exemption within the meaning of this article.

A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year is not required to include in gross income such income from sources within the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption requirements of the statute.

SEC. 213. *Deductions.*—(a) *General rule.*—In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) *Losses.*—(1) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 23 (e) (2) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this title.

(2) The deduction for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 23 (e) (3), shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

(c) *Charitable, etc., contributions.*—The so-called "charitable contribution" deduction allowed by section 23 (o) shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to the vocational rehabilitation fund.

ART. 213–1. *Deductions allowed nonresident alien individuals—(a) No United States business or office.*—(1) *General rule.*—In general, a nonresident alien individual not engaged in trade or

business within the United States and not having an office or place of business therein at any time during the taxable year is not allowed any deductions, the tax being imposed upon the amount of gross income received.

(2) *Aggregate more than $21,600.*—A nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year but deriving for such year more than $21,600 gross amount of fixed or determinable annual or periodical income from sources within the United States is allowed for such year only such deductions as are properly allocable to such income. He is also allowed the contributions or gifts made within the taxable year whether or not connected with income from sources within the United States but only if made to domestic corporations or to community chests, funds, or foundations created in the United States of the type specified in section 23 (o), or to the vocational rehabilitation fund, subject to the limitations provided in section 23 (o).

(b) *United States business or office.*—In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States or had an office or place of business therein the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. (See also section 215.) In the case of such taxpayers, however, (1) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, although not connected with the trade or business, are (if otherwise allowable) deductible only if and to the extent that the profit, if such transaction had resulted in a profit, would have been taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise, are deductible only if the property was located within the United States; and (3) contributions or gifts made within the taxable year are deductible, only if made to domestic corporations or to community chests, funds, or foundations, created in the United States, of the type specified in section 23 (o), or to the vocational rehabilitation fund, subject to the limitation provided in section 23 (o).

Losses embraced under clause (2) of the preceding pargraph are deductible in full from items of gross income specified as being derived in full from sources within the United States, and, if greater than the sum of such items, the unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of article 119–12. Losses embraced under clause (1) are deductible in full (as provided in article 119–10 or article 119–11) when the profit from the transaction, if it had resulted in a profit, would have been taxable in full as income from sources within the United States, but should be deducted under the provisions of article 119–12 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part.

SEC. 214. *Credits against net income.*

In the case of a nonresident alien individual the personal exemption allowed by section 25 (b) (1) of this title shall be only $1,000. The credit for dependents allowed by section 25 (b) (2) shall not be allowed in the case of a nonresident alien individual unless he is a resident of a contiguous country.

ART. 214–1. *Credits to nonresident alien individuals.*—(a) *No United States business or office.*—(1) *General rule*—In general, a nonresident alien individual not engaged in trade or business in the United States and not having an office or place of business therein at any time during the taxable year is not allowed any credits under section 25, the tax being imposed upon the amount of gross income received.

(2) *Aggregate more than $21,600.*—In the case of a nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year and deriving in such year gross amount of fixed or determinable annual or periodical income from sources within the United States of more than $21,600, the credits allowed are those applicable in the case of nonresident alien individuals engaged in trade or business within the United States or having an office or place of business therein.

(b) *United States business or office.*—In the case of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States or had an office or place of business therein, the personal exemption allowed as a credit against net income by section 25 (b) (1) shall be $1,000, whether such alien is a single person, a married person living with husband or wife, or the head of a family. The credit for dependents provided by section 25 (b) (2) is allowed to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States or had an office or place of business therein only if they are residents of Canada or Mexico. If the status of the taxpayer as to dependents changes during the taxable year, the credit for dependents shall be determined as provided in article 25–7.

SEC. 215. *Allowance of deductions and credits.*—(a) *Return to contain information.*—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) *Tax withheld at source.*—The benefit of the personal exemption and credit for dependents may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

ART. 215–1. *Allowance of deductions and credits to nonresident alien individuals*—(a) *No United States business or office*—(1) *General rule.*—In general, a nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year is not entitled to any allowance of deductions or credits even though he may file a return of income.

(2) *Aggregate more than $21,600.*—Unless a nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year and having, for such year from sources within the United States, fixed or determinable annual or periodical income in a gross amount of more than $21,600, shall file or cause to be filed with the collector a true and accurate return of his total fixed or determinable annual or periodical income from sources within the United States as required by paragraph (a) (2) of article 217–2, the tax shall be collected on the basis of gross amount of such fixed or determinable annual or periodical income. Where such nonresident alien has various sources of fixed or determinable annual or periodical income from within the United States, as, for instance, from an estate or trust, from stocks or bonds held directly by him, or from securities held for him by a custodian resident in the United States, so that his total gross fixed or determinable annual or periodical income from United States sources is in excess of $21,600 and a return of income is not filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the fixed or determinable annual or periodical income from all sources within the United States concerning which he has information without allowance for deductions and credits, and will assess the tax and collect it from one or more of the sources of income within the United States. Such nonresident alien shall make or have made a full and accurate return on Form 1040 NB–a of all his fixed or determinable annual or periodical income from sources within the United States. As to the duty of the representative or agent of such alien to file the return

and pay the tax, see paragraph (*b*) of article 217–2, which is hereby made equally applicable in the case of a nonresident alien individual coming within the provisions of this paragraph.

(*b*) *United States business or office.*—Unless a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States or had an office or place of business therein shall file, or cause to be filed, with the collector, a true and accurate return of his total income from sources within the United States, as required by paragraph (*b*) of article 217–2, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a nonresident alien has various sources of income within the United States, so that his total income calls for the assessment of a surtax, and a return of income was not filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the income of such nonresident alien from all sources concerning which he has information, without allowance for deductions or credits, and will assess the tax and collect it from one or more of the sources of income of such nonresident alien within the United States.

SEC. 216. *Credits against tax.*—A nonresident alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 217. *Returns.*—(*a*) *Requirement.*—In the case of a nonresident alien individual the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then on or before the fifteenth day of June.

(*b*) *Exemption from requirement.*—Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, nonresident alien individuals subject to the tax imposed by section 211 (a) may be exempted from the requirement of filing returns of such tax.

ART. 217–1. *Time and place for filing returns of nonresident alien individuals.*—The return in the case of a nonresident alien individual must be made on or before the 15th day of the sixth month following the close of the fiscal year or on or before the 15th day of June, if on the basis of the calendar year. The return must be filed with the collector of internal revenue for the district in which the nonresident alien individual has his principal place of business in the United States, or if he has no principal place of business in the United States, then with the collector of internal revenue at Baltimore, Md. For failure to make and file return within the time prescribed see section 291. For cases in which no return is required see paragraph (*a*) of article 217–2.

ART. 217–2. *Return of income*—(*a*) *No United States business or office*—(1) *General rule.*—If the tax liability of a nonresident alien individual, not engaged in trade or business within the United States and not having any office or place of business therein at any time during the taxable year, is fully satisfied at the source a return of income is not required. A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year shall make or have made a return on Form 1040NB with respect to that portion of his income received from sources within the United States consisting of interest on so-called tax-free covenant bonds on which a tax of only 2 percent was withheld at the source, and with respect to any other fixed or determinable annual or periodical income upon which the tax was not fully satisfied at the source, including dividends received from a foreign corporation which are treated as income from sources within the United States under section 119 (a) (2) (B), and shall pay the balance of the tax shown to be due.

(2) *Aggregate more than $21,600.*—A nonresident alien individual (other than a resident of Canada) not engaged in trade or business within the United States and not having an office or place of business therein at any time during the taxable year deriving in such year more than $21,600 gross amount of fixed or determinable annual or periodical income from sources within the United States, shall make or have made a full and accurate return on Form 1040 NB–a of all his fixed or determinable annual or periodical income from sources within the United States. Such return need not disclose profits derived from the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commisson agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein. As to the duty of the representative or agent of such alien to file the return and pay the tax, see paragraph (*b*) of this article, which is hereby made equally applicable in the case of a nonresident alien coming within the provisions of this paragraph.

(*b*) *United States business or office.*—If a nonresident alien individual at any time within the taxable year is engaged in trade or business within the United States or has an office or place of business therein he shall make or have made a full and accurate return on Form 1040B of his income received from all sources within the United States. A return will not be required, however, in the case of such a nonresident alien individual, a resident of Canada or Mexico, whose sole income from sources within the United States consists of compensation for personal services and does not exceed $1,000 during the taxable year.

The responsible representative or agent within the United States of a nonresident alien individual who at any time within the taxable year was engaged in trade or business within the United States or had an office or place of business therein, shall make in behalf of his nonresident alien principal, a return of, and shall pay the tax on, all income from sources within the United States coming within his control as representative or agent. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. See article 51–2. Any person who collects interest or dividends on deposited securities of such a nonresident alien, executes ownership certificates in connection therewith and sells such securities under special instructions shall not be deemed merely by reason of such acts to be the responsible representative or agent of the nonresident alien. Where upon filing a return of income it appear that such a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there should be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. (See article 143–4.)

SEC. 218. *Payment of tax.*—(*a*) *Time of payment.*—In the case of a nonresident alien individual the total amount of tax imposed by this title shall be paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year.

(*b*) *Withholding at source.*—For withholding at source of tax on income of nonresident aliens, see section 143.

ART. 281–1. *Date on which tax shall be paid by nonresident alien individual.*—In the case of a nonresident alien individual the tax is to be paid on or before the 15th day of June following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the 15th day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see article 56–1.

SEC. 219. *Partnerships.*—For the purpose of this title, a nonresident alien individual shall be considered as being engaged in a trade or business within the United States if the partnership of which he is a member is so engaged and as having an office or place of business within the United States if the partnership of which he is a member has such an office or place of business.

ART. 219–1. *Partnerships.*—Whether a nonresident alien individual who is a member of a partnership is taxable under the provisions of (A) section 211 (a) or 211 (c) or (B) section 211 (b) may depend on the status of the partnership. A nonresident alien individual who is a member of a partnership which is not engaged in trade or business within the United States and has no office or place of business therein is sub-

ject to the provisions of section 211 (a) or 211 (c), as the case may be, depending on whether in the taxable year he derives fixed or determinable annual or periodical income from sources within the United States of more than $21,600, if he is not otherwise engaged in trade or business within the United States and has no office or place of business therein. A nonresident alien individual who is a member of a partnership which at any time within the taxable year is engaged in trade or business within the United States or has an office or place of business therein is considered as being engaged in trade or business within the United States or as having an office or place of business therein and is therefore taxable under section 211 (b). For definition of what the term "partnership" includes see section 901 (a) (3). The test of whether a partnership is engaged in trade or business within the United States, or has an office or place of business therein, is the same as in the case of a nonresident alien individual. (See article 211–7.)

CHAPTER XXVII

Foreign Corporations

Supplement I—Foreign Corporations

SEC. 231. *Tax on foreign corporations.*—(a) *Nonresident corporations.*—There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 13 and 14, upon the amount received by every foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, a tax of 15 per centum of such amount, except that in the case of dividends the rate shall be 10 per centum, and except that in the case of corporations organized under the laws of a contiguous country such rate of 10 per centum with respect to dividends shall be reduced to such rate (not less than 5 per centum) as may be provided by treaty with such country. For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(b) *Resident corporations.*—A foreign corporation engaged in trade or business within the United States or having an office or place of business therein shall be taxable as provided in section 14 (e) (1).

(c) *Gross income.*—In the case of a foreign corporation gross income includes only the gross income from sources within the United States.

(d) *Ships under foreign flag.*—The income of a foreign corporation, which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, shall not be included in gross income and shall be exempt from taxation under this title.

ART. 231–1. *Taxation of foreign corporations.*—For the purposes of this article and articles 231–2, 232–1, 235–1, 235–2, and 236–1, foreign corporations are divided into two classes: (a) foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year, referred to in the regulations as nonresident foreign corporations (see article 901–8); and (b) foreign corporations which at any time within the taxable year are engaged in trade or business within the United States or have an office or place of business therein, referred to in the regulations as resident foreign corporations (see article 901–8).

(a) *Nonresident foreign corporations.*—A nonresident foreign corporation is liable to the tax upon the amount received from sources within the United States, determined under the provisions of section 119, which is fixed or determinable annual or periodical gains, profits, and income. For the purposes of section 231 (a), the term "amount received" means "gross income." Specific items of fixed or determinable annual or periodical income are enumerated in the Act as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, but other fixed or determinable annual or periodical gains, profits, and income are also subject to the tax, as, for instance, royalties. As to the definition of fixed or determinable annual or periodical income see article 143–2. The items of fixed or determinable annual or periodical income from sources within the United States received by a corporation organized under the laws of France, which are exempt from Federal income tax under the provisions of the convention and protocol between the United States and France signed April 27, 1932, and effective January 1, 1936, are described in article 143–3.

The fixed or determinable annual or periodical income from sources within the United States, including royalties, but excluding dividends, of a nonresident foreign corporation is taxable at the rate of 15 percent. Dividends which are treated as income from sources within the United States are taxable at the rate of 10 percent, except that in the case of a nonresident foreign corporation organized under the laws of a contiguous country, such rate of 10 percent shall be reduced to such rate (not less than 5 percent) as may be provided by treaty with such country.

(b) *Resident foreign corporations.*—A resident foreign corporation is not taxable at the rate of 15 percent upon the items of fixed or determinable annual or periodical income enumerated in section 231 (a). A resident foreign corporation is liable to a tax of 19 percent upon its special class net income, that is, its net income from sources within the United States (gross income from sources within the United States minus the statutory deductions provided in sections 23 and 232) less the credits allowed against net income by section 26 (a) and (b). (See section 14 (a).)

As used in section 231, section 119, section 143, section 144, and section 211, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian.

Whether a foreign corporation has an "office or place of business" within the United States depends upon the facts in a particular case. The term "office or place of business," however, implies a place for the regular transaction of business and does not include a place where casual or incidental transactions might be, or are, effected.

ART. 231–2. *Gross income of foreign corporations.*—In the case of a foreign corporation, including a life insurance company not carrying on an insurance business within the United States and holding no reserve funds upon business transacted within the United States (see section 201 (b) (3)), an insurance company other than life or mutual not carrying on an insurance business within the United States (see section 204 (a) (3)) and a mutual insurance company other than life not carrying on an insurance business within the United States (see section 207 (a)), the term "gross income" means gross income from sources within the United States as defined and described in section 119. (See articles 119–1 to 119–14.) The items of gross income from sources without the United States and therefore not taxable to foreign corporations are described in section 119 (c). As to the definition of a foreign corporation see section 901 (a) (2) and (5). As to foreign life insurance companies, see article 201 (b)–2. As to foreign corporations formed or availed of to avoid surtax see article 102–4. As to personal holding companies organized under the laws of foreign countries, see article 406–1. As to foreign personal holding companies, see Chapter XXXIV.

(a) *Nonresident foreign corporations.*—A nonresident foreign corporation is taxable under section 231 (a) only on fixed or determinable annual or periodical gross income received from sources within the United States. Its taxable income does not include profits derived from the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian, or profits derived from the sale within the United States of personal property or real property located therein.

(b) *Resident foreign corporations.*—The gross income from sources within the United States of a resident foreign corporation is not limited to the items of fixed or determinable annual or periodical income referred to in section 231

(a), but includes every item of gross income which is treated as income from sources within the United States, except those items which are specifically exempt from taxation by statute or treaty or which are not taxable by the Federal Government under the Constitution. (See sections 22 (b), 119, and 231 (d).)

A foreign corporation which effects transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian is not merely by reason of such transactions considered as being engaged in trade or business within the United States which would cause it to be classed as a resident foreign corporation. However, a foreign corporation which at any time within the taxable year is otherwise engaged in trade or business in the United States or has an office or place of business therein, being a resident foreign corporation, is taxable upon all income derived from sources within the United States, including the profits realized from such transactions. A resident foreign corporation is also required to include in its gross income capital gains, gains from hedging transactions, and profits derived from the sale within the United States of personal property, or of real property located therein.

ART. 231–3. *Exclusion of earnings of foreign ships from gross income.*—A resident foreign corporation may exclude from gross income under section 231 (d) so much of its income from sources within the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country, to the same extent as provided in article 212–2 with respect to nonresident alien individuals.

A nonresident foreign corporation is not required to include in gross income such income from sources within the United States as is derived from the operation of a ship or ships, whether or not the foreign country under the laws of which such ships are documented meets the equivalent exemption requirements of the statute.

SEC. 232. *Deductions.*—(a) *In general.*—In the case of a foreign corporation the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) *Charitable, and so forth, contributions.*—The so-called "charitable contribution" deduction allowed by section 23 (q) shall be allowed whether or not connected with income from sources within the United States.

ART. 232–1. *Deductions allowed foreign corporations.*—(a) *Nonresident foreign corporations.*—A nonresident foreign corporation is not allowed any deductions from gross income from sources within the United States, the tax being imposed upon the amount of gross income received. (See article 231–1.)

(b) *Resident foreign corporations.*—A resident foreign corporation is allowed the same deductions from its gross income arising from sources within the United States as are allowed a domestic corporation under section 23 to the extent that such deductions are connected with such gross income, except that the so-called charitable contribution deduction allowed by section 23 (q) is allowed whether or not connected with income from sources within the United States. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119. As to foreign life insurance companies, see article 201 (b)–2. As to foreign corporations formed or availed of to avoid surtax, see article 102–4. As to personal holding companies organized under the laws of foreign countries, see article 406–1. As to foreign personal holding companies, see Chapter XXXIV.

SEC. 233. *Allowance of deductions and credits.*—A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this title only by filing or causing to be filed with the collector a true and accurate return of its total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

ART. 233–1. *Allowance of deductions and credits.*—The benefit of the deductions and credits allowed a resident foreign corporation can be had only by filing or causing to be filed with the collector a true and accurate return of its total income received from sources within the United States. Only items of interest and dividends included in gross income may be credited under section 26 (a) and (b). Inasmuch as a nonresident foreign corporation is taxable under section 231 (a) only upon fixed or determinable annual or periodical gross income received from sources within the United States, such foreign corporation may not receive the benefit of the deductions and credits by filing a return of income.

SEC. 234. *Credits against tax.*—Foreign corporations shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 235. *Returns.*—(a) *Time of filing.*—In the case of a foreign corporation not having any office or place of business in the United States the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year then on or before the fifteenth day of June. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent.

(b) *Exemption from requirement.*—Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, corporations subject to the tax imposed by section 231 (a) may be exempted from the requirement of filing returns of such tax.

ART. 235–1. *Time and place for filing returns of foreign corporations.*—(a) *Nonresident foreign corporations.*—The return in the case of a nonresident foreign corporation must be made on or before the 15th day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of a calendar year then on or before the 15th day of June. If a nonresident foreign corporation has an agent in the United States, the return shall be made by the agent. The return must be filed with the collector of internal revenue, Baltimore, Md. (See section 53 (b) (2).) For failure to make and file a return within the time prescribed, see section 291. For cases in which no return is required see paragraph (a) of article 235–2.

(b) *Resident foreign corporations.*—The return in the case of a resident foreign corporation, in lieu of the time prescribed in section 235, shall be made on or before the 15th day of the third month following the close of the fiscal year, or on or before the 15th day of March if on the basis of the calendar year. (See section 53 (a) (1).) The return must be filed with the collector of internal revenue for the district in which the resident foreign corporation has its principal place of business or principal office or agency in the United States. (See section 53 (b) (2).) For failure to make and file a return within the time prescribed see section 291.

ART. 235–2. *Return of income.*—(a) *Nonresident foreign corporations.*—If the tax liability of a nonresident foreign corporation is fully satisfied at the source a return of income is not required. A nonresident foreign corporation shall make or have made a return on Form 1120NB with respect to that portion of its income received from sources within the United States consisting of interest on so-called tax-free covenant bonds on which a tax of only 2 percent was withheld at the source, and with respect to any other fixed or determinable annual or periodical income upon which the tax was not fully satisfied at the source, including dividends received from a foreign corporation which are treated as income from sources within the United States under section 119 (a) (2) (B), and shall pay the balance of the tax shown to be due.

(b) *Resident foreign corporations.*—If a foreign corporation at any time within the taxable year is a resident corporation it shall make a full and accurate return on Form 1120 of its income received from sources within the United States.

SEC. 236. *Payment of tax.*—(a) *Time of payment.*—In the case of a foreign corporation not having any office or place of business in the United States the total amount of tax imposed by this title shall be

paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year.

(b) *Withholding at source.*—For withholding at source of tax on income of foreign corporations, see section 144.

ART. 236–1. *Dates on which tax shall be paid by foreign corporations*—(a) *Nonresident foreign corporations.*—In the case of a nonresident foreign corporation the total amount of tax imposed by section 231 (a) shall be paid on the 15th day of June following the close of the calendar year, or if the return should be made on the basis of a fiscal year, then on the 15th day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see article 56–1.

(b) *Resident foreign corporations.*—In the case of a resident foreign corporation the total amount of tax provided by sections 231 (b) and 14 (e) (1) shall be paid, in lieu of the time prescribed in section 236 (a), on the 15th day of March following the close of the calendar year, or if the return is made on the basis of a fiscal year, then on the 15th day of the third month following the close of the fiscal year. As to payment of the tax in installments see article 56–1.

SEC. 237. *Foreign insurance companies.*—For special provisions relating to foreign insurance companies, see Supplement G.

SEC. 238. *Affiliation.*—A foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of section 141.

CHAPTER XXVIII

Income From Sources Within Possessions of United States

Supplement J—Possessions of the United States

SEC. 251. *Income from sources within possessions of United States.*—(a) *General rule.*—In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) *Amounts received in United States.*—Notwithstanding the provisions of subsection (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) *Tax in case of corporations.*—A domestic corporation entitled to the benefits of this section shall be taxable as provided in section 14 (d). For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

(d) *Definition.*—As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

(e) *Deductions.*—(1) Citizens of the United States entitled to the benefits of this section shall have the same deductions as are allowed by Supplement H in the case of a nonresident alien individual engaged in trade or business within the United States or having an office or place of business therein.

(2) Domestic corporations entitled to the benefits of this section shall have the same deductions as are allowed by Supplement I in the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein.

(f) *Credits against net income.*—A citizen of the United States entitled to the benefits of this section shall be allowed a personal exemption of only $1,000 and shall not be allowed the credit for dependents provided in section 25 (b) (2).

(g) *Allowance of deductions and credits.*—Citizens of the United States and domestic corporations entitled to the benefits of this section shall receive the benefit of the deductions and credits allowed to them in this title only by filing or causing to be filed with the collector a true and accurate return of their total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(h) *Credits against tax.*—Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

(i) *Affiliation.*—A corporation entitled to the benefits of this section shall not be deemed to be affiliated with any other corporation within the meaning of section 141.

ART. 251–1. *Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.*—In the case of a citizen of the United States or a domestic corporation satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and

(2) If 50 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States. In the case of a citizen, the trade or business may be conducted on his own account or as an employee or agent of another.

The salary or other compensation paid by the United States to the members of its civil, military, or naval personnel for services rendered within a possession of the United States represents income derived from the active conduct of a trade or business within a possession of the United States. Dividends received by a citizen from a corporation whose income was derived from the active conduct of a business within a possession of the United States, although such citizen was actively engaged in the management of such corporation, does not represent income derived from the active conduct of a trade or business within the possession of the United States, either on the taxpayer's own account or as an employee or agent of another.

A citizen of the United States who on account of the nature and amount of his income cannot meet the 80 percent and the 50 percent requirements of the statute, but who receives earned income from sources within a possession of the United States is not deprived of the benefits of the provisions of section 116 (a), provided he is away from the United States for more than six months of the taxable year, and does not receive his earned income from the United States or any agency thereof. In such a case none of the provisions of section 251 is applicable in determining the citizen's tax liability. For what constitutes earned income see section 25 (a) (4).

For a determination of the income from sources within the United States, see section 119. A citizen entitled to the benefits of section 251 is required to file with his individual return Form 1040 or 1040 A, the schedule on Form 1040 E. If a citizen entitled to the benefits of section 251 has no income from sources within the United States or does not receive within the United States any income whether derived from sources within or without the United States, he is not required to file a return or the schedule on Form 1040 E.

Example: On July 1, 1938, A, who is a citizen of the United States, went to Puerto Rico and established a business there which he actively conducted during the remainder of that year. His gross income from the business during such period was $20,000. In addition, he made a profit of $12,000 from the sale during the latter part of 1938 of some Puerto Rican real estate not connected with his trade or business. In the first six months of 1938 he also derived $8,000 gross income from rental property located in the United States. He derived a like amount of gross income from such property during the last six months of 1938. Inasmuch as for the applicable part (July 1, 1938, to December 31, 1938) of the 3-year period immediately preceding the close of the taxable year (the calendar year 1938), 80 percent of A's gross income ($32,000, or 80 percent of $40,000) was derived from sources within a possession of the

United States and as 50 percent or more of his gross income ($20,000, or 50 percent of $40,000) for such part of the 3-year period was derived from the active conduct of a trade or business within a possession of the United States, he is required to report in gross income in his return for 1938 only the gross income derived by him from sources within the United States ($16,000 from the rental property located in the United States).

ART. 251–2. *Income received within the United States.*—Notwithstanding the provisions of section 251 (a), there shall be included in the gross income of citizens and domestic corporations therein specified all amounts, whether derived from sources within or without the United States, which are received by such citizens or corporations within the United States. From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated thereto. For instance, if in the example given in article 251–1, the taxpayer during the latter part of 1938 returned to the United States for a few weeks and while there received the proceeds resulting from the sale of the Puerto Rican real estate, the profits derived from such transaction should be reported in gross income. Such receipt in the United States, however, would not deprive the taxpayer of the benefits of section 251 with respect to other items of gross income excluded by that section.

ART. 251–3. *Tax in case of corporations.*—A domestic corporation entitled to the benefits of section 251 is taxable at the rate of 16½ percent as provided in sections 251 (c) and 14 (d) and is not subject to the tax imposed by section 13.

ART. 251–4. *Definition.*—The term "United States" as used herein includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "possession of the United States," as used in sections 251 and 252 and article 251–1, this article, and article 252–1, includes Puerto Rico, the Philippine Islands, the Panama Canal Zone, Guam, American Samoa, Wake, Palmyra, and the Midway Islands; it does not include the Virgin Islands. The Philippine Islands come within the classification of "possessions of the United States" for Federal income tax purposes, notwithstanding the establishment of the Commonwealth of the Philippines under the Act of March 24, 1934 (48 Stat., 456).

ART. 251–5. *Deductions allowed citizens and domestic corporations entitled to the benefits of section 251.*—In the case of a citizen entitled to the benefits of section 251, the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. The provisions of article 213–1 relating to the allowance to nonresident alien individuals who at any time within the taxable year were engaged in trade or business within the United States or had an office or place of business therein, of the deductions provided in paragraphs (2) and (3) of section 23 (e) for losses not connected with the trade or business are applicable in the case of citizens entitled to the benefits of section 251. The provisions of that article pertaining to the allowance to such nonresident alien individuals of deductions for contributions provided in section 23 (o) are also applicable in the case of such citizens. Corporations entitled to the benefits of section 251 are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income, except that the so-called charitable contribution deduction allowed by section 23 (q) is allowed whether or not connected with income from sources within the United States. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119.

ART. 251–6. *Allowance of deductions and credits to citizens and domestic corporations entitled to the benefits of section 251.*—Unless a citizen of the United States or a domestic corporation entitled to the benefits of section 251 shall file, or cause to be filed with the collector, a true and accurate return of total income from sources within the United States, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a citizen or corporation has various sources of income within the United States so that the total income calls for the assessment of a tax, and a return of income was not filed by or on behalf of the citizens or corporation, the Commissioner will cause a return of income to be made and include therein the income of such citizen or corporation from all sources concerning which he has information, and will assess the tax and collect it from one or more of the sources of income of such citizen or corporation within the United States without allowance for deductions or credits.

SEC. 252. *Citizens of possessions of United States.*

(a) Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

(b) Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921, relating to the imposition of income taxes in the Virgin Islands of the United States.

ART. 252–1. *Status of citizens of United States possession.*—A citizen of a possession of the United States (except the Virgin Islands), who is not otherwise a citizen or resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. (See sections 211–219.) For Federal income tax purposes a citizen of a possession of the United States who is not otherwise a citizen of the United States, is a citizen of a possession of the United States who has not become a citizen of the United States by naturalization. The fixed or determinable annual or periodical income from sources within the United States of a citizen of a possession of the United States who is treated as if he were a nonresident alien individual is subject to withholding. (See section 143.)

For the purpose of this article citizens of the possessions of the United States who are not otherwise citizens of the United States are divided into two classes: (1) citizens of possessions of the United States who at any time within the taxable year are not engaged in trade or business within the United States and have no office or place of business therein and (2) citizens of possessions of the United States who at any time within the taxable year are engaged in trade or business within the United States or have an office or place of business therein. The provisions of articles 211–7 to 219–1, inclusive, applicable to nonresident alien individuals not engaged in trade or business within the United States and not having an office or place of business therein are applicable to the citizens of possessions falling within the first class, while the provisions of such articles applicable to nonresident alien individuals who at any time within the taxable year are engaged in trade or business within the United States or have an office or place of business therein are applicable to citizens of possessions falling within the second class.

The Act referred to in section 252 (b) provides that income tax laws then or thereafter in force in the United States shall apply to the Virgin Islands, but that the taxes shall be paid into the treasury of the Virgin Islands. Accordingly, persons are taxed there under the provisions of the Revenue Act of 1938.

CHAPTER XXIX

China Trade Act Corporations

Supplement K—China Trade Act Corporations

SEC. 261. *Taxation in general.*—A corporation organized under the China Trade Act, 1922, shall be taxable as provided in section 14 (d). For inclusion in computation of tax of amount specified in shareholder's consent, see section 28.

SEC. 262. *Credit against net income.*—(a) *Allowance of credit.*—For the purpose only of the taxes imposed by sections 14 and 602 of this Act and section 106 of the Revenue Act of 1935 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, in addition to the credits against net income otherwise allowed such corporation, a credit against the net income of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: *Provided*, That in no case shall the diminution, by reason of such credit, of the tax imposed by such section 14 (computed without regard to this section) exceed the amount of the special dividend certified under subsection (b) of this section; and in no case shall the diminution, by reason of such credit, of the tax imposed by such section 106 or 602 (computed without regard to this section) exceed the amount by which such special dividend exceeds the diminution permitted by this section in the tax imposed by such section 14.

(b) *Special dividend.*—Such credit shall not be allowed unless the Secretary of Commerce has certified to the Commissioner—

(1) The amount which, during the year ending on the date fixed by law for filing the return, the corporation has distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation;

(2) That such special dividend was in addition to all other amounts, payable or to be payable to such persons or for their benefit, by reason of their interest in the corporation; and

(3) That such distribution has been made to or for the benefit of such persons in proportion to the par value of the shares of stock of the corporation owned by each; except that if the corporation has more than one class of stock, the certificates shall contain a statement that the articles of incorporation provide a method for the apportionment of such special dividend among such persons, and that the amount certified has been distributed in accordance with the method so provided.

(c) *Ownership of stock.*—For the purposes of this section shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

(d) *Definition of China.*—As used in this section the term "China" shall have the same meaning as when used in the China Trade Act, 1922.

SEC. 263. *Credits against the tax.*—A corporation organized under the China Trade Act, 1922, shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 264. *Affiliation.*—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of section 141.

SEC. 265. *Income of shareholders.*—For exclusion of dividends from gross income, see section 116.

ART. 262–1. *Income of China Trade Act corporations.*—The items of gross income to be included in the return of a corporation organized under the China Trade Act and the deductions allowable are the same as in the case of other domestic corporations.

ART. 262–2. *Credits allowed China Trade Act corporations.*—In addition to the credits allowed under section 26 (a) and (b), a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the taxes imposed by sections 14 (d) and 602 of the Revenue Act of 1938 and section 106 of the Revenue Act of 1935. This credit is an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation, owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date. The decrease in the tax imposed by section 14 (d) by reason of such credit must not, however, exceed the amount of the special dividend referred to in section 262 (b), and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce. The decrease in the tax imposed by section 602 of the Revenue Act of 1938 or section 106 of the Revenue Act of 1935 by reason of such credit must not exceed the amount by which such special dividend exceeds the decrease permitted by section 262 in the tax imposed by section 14 (d). A China Trade Act corporation is not entitled to the credit for taxes paid to foreign countries and possessions of the United States allowed to domestic corporations under the provisions of section 131.

The application of this article may be illustrated by the following example:

Example: The A Company, a China Trade Act corporation, has a net income for the calendar year 1938 (before deducting excess-profits tax) of $200,000 and receives no dividends from domestic corporations. All of its stock on December 31, 1938, is owned on that date by persons resident in China, the United States, or possessions of the United States, or individual citizens of the United States or China. The adjusted declared value of the capital stock of the corporation shown on its capital stock tax return for the capital stock tax year ended June 30, 1938, is $1,500,000. It distributes a special dividend amounting to $36,000 on February 15, 1939, which is certified by the Secretary of Commerce as provided in section 262 (b).

For the purpose of the tax imposed by section 14 (d) it is necessary in this example to make two computations, first, without allowing the special credit against net income on account of income derived from sources within China, and, second, allowing such credit. The computations are as follows:

First Computation

Without Allowing the Special Credit Against Net Income

Net income subject to tax	$200,000
Special class net income	200,000
Tax as 16½ percent	33,000
Total normal tax	33,000

Second Computation

Allowing Special Credit Against Net Income

Net income	$200,000
Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible as a special credit against net income.	
Special credit against net income	$200,000
Amount of income subject to tax under section 14 (d)	None

Since the special dividend ($36,000) exceeds the diminution of the tax ($33,000) on account of the allowance of the special credit against net income, the entire amount of the special credit is allowable and the corporation has no income tax liability for 1938.

For the purpose of the excess-profits tax it is also necessary to make two computations, first, without allowing the special credit against net income, and, second, allowing such credit. The computations are as follows:

First computation

Without allowing the special credit against net income

Net income	$200,000
Less: 10 percent of the value declared in the capital stock tax return for the capital stock tax year ended June 30, 1938 (10 percent of $1,500,000)	150,000
Net income subject to excess-profits tax	50,000
Less: Amount taxable at 6 percent, portion of net income in excess of 10 percent and not in excess of 15 percent of the adjusted declared value of the capital stock ($200,000 minus $150,000)	50,000
Amount taxable at 12 percent	None
Excess-profits tax at 6 percent (6 percent of $50,000)	3,000

Second computation

Allowing special credit against net income

Net income	$200,000
Since the total net income is derived from sources within China and since the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, is 100 percent of the par value of the total number of shares of stock of the corporation outstanding on that day, 100 percent of the net income from sources within China is deductible from net income	200,000
Amount of income subject to excess-profits tax	None

Since the diminution of the excess-profits tax ($3,000) on account of the special credit against net income does not exceed the amount by which the special dividend ($36,000) exceeds the diminution of the income tax ($33,000) on account of such credit, the entire amount of the special credit ($200,000) is allowable and the corporation has no excess-profits tax liability for 1938.

ART. 262–3. *Meaning of terms used in connection with China Trade Act corporations.*—A China Trade Act corporation is one organized under the provisions of the China Trade Act, 1922.

The term "China" means (1) China, including Manchuria, Tibet, Mongolia, and any territory leased by China to any foreign government, (2) the Crown Colony of Hongkong, and (3) the Province of Macao.

The term "special dividend" means the amount which during the year ending on March 15 succeeding the close of the corporation's taxable year is distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation. Such special dividend does not include any other amounts payable or to be payable to such persons or for their benefit by reason of their interest in the corporation and must be made in proportion to the par value of the shares of stock of the corporation owned by each.

For the purposes of section 262 the shares of stock of a China Trade Act corporation are considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

"Net income derived from sources within China" is the sum of the net income from sources wholly within China and that portion of the net income from sources partly within and partly without China which may be allocated to sources within China. The method of computing this income is similar to that described in section 119.

ART. 262–4. *Withholding by a China Trade Act corporation.*—Dividends distributed by a corporation organized under the China Trade Act, 1922, which are treated as income from sources within the United States under the provisions of section 119 of the Act are subject to withholding at the rate of 10 percent when paid to persons (other than residents of China) who are (1) nonresident aliens, (2) nonresident partnerships composed in whole or in part of nonresident aliens, or (3) nonresident foreign corporations. The 10 percent rate of withholding specified in this article with respect to dividends shall be reduced in the case of shareholders who are (*a*) nonresident aliens residents of a contiguous country or (*b*) nonresident foreign corporations organized under the laws of a contiguous country, to such rate (not less than 5 percent), as may be provided by treaty with such country. As to reduction in rate of withholding (*a*) in the case of nonresident alien individuals, residents of Canada, see article 143–1; (*b*) in the case of nonresident foreign corporations organized under the laws of Canada, see article 144–1.

CHAPTER XXX

Assessment and Collection of Deficiencies

Supplement L—Assessment and Collection of Deficiencies

SEC. 271. *Definition of deficiency.*—As used in this title in respect of a tax imposed by this title "deficiency" means—

(a) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

(b) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed, or collected without assessment, shall first be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

ART. 271–1. *Deficiency defined.*—Section 271 by its definition of the word "deficiency" provides a term which will apply to any amount of tax determined to be due in respect of any taxable year beginning after December 31, 1937, in excess of the amount of tax reported by the taxpayer for such year; or in excess of the amount reported by the taxpayer as adjusted by way of prior assessments, abatements, credits, refunds, or collections without assessment. In defining the term "deficiency" section 271 recognizes two classes of cases—one, where the taxpayer makes a return showing some tax liability; the other, where the taxpayer makes a return showing no tax liability, or where the taxpayer fails to make a return. Additional tax shown on an "amended return," so called, is a deficiency within the meaning of the Act.

When a case is considered for the first time, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount shown as the tax by the taxpayer on his return, or, if it is a case where no tax was reported by the taxpayer, the deficiency is the amount determined to be the correct amount of the tax. Subsequent information sometimes discloses that the amount previously determined to be the correct amount of the tax is less than the correct amount, and that a redetermination of the tax is necessary. In such a case the deficiency on redetermination is the excess of the amount determined to be the correct amount of the tax over the sum of the amount of tax reported by the taxpayer and the deficiency assessed in connection with the previous determination. If it is a case where no tax was reported by the taxpayer, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of the deficiency disclosed by the previous determination. If the previous determination resulted in a credit or refund to the taxpayer, the deficiency upon the second determination is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer decreased by the amount of the credit or refund.

SEC. 272. *Procedure in general.*—(*a*) *Petition to Board of Tax Appeals.*—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3224 of the Revised Statutes the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. In the case of a joint return filed by husband and wife such notice of deficiency may be a single joint notice, except that if the Commissioner has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, duplicate originals of the joint notice must be sent by registered mail to each spouse at his last known address.

For exceptions to the restrictions imposed by this subsection, see—

(1) Subsection (d) of this section, relating to waivers by the taxpayer;

(2) Subsection (f) of this section, relating to notifications of mathematical errors appearing upon the face of the return;

(3) Section 273, relating to jeopardy assessments;
(4) Section 274, relating to bankruptcy and receiverships; and
(5) Section 1001 of the Revenue Act of 1926, as amended, relating to assessment or collection of the amount of the deficiency determined by the Board pending court review.

(*b*) *Collection of Deficiency found by Board.*—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

(*c*) *Failure to file petition.*—If the taxpayer does not file a petition with the Board within the time prescribed in subsection (a) of this section, the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the collector.

(*d*) *Waiver of restrictions.*—The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subsection (a) of this section on the assessment and collection of the whole or any part of the deficiency.

(*e*) *Increase of deficiency after notice mailed.*—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

(*f*) *Further deficiency letters restricted.*—If the Commissioner has mailed to the taxpayer notice of a deficiency as provided in subsection (a) of this section, and the taxpayer files a petition with the Board within the time prescribed in such subsection, the Commissioner shall have no right to determine any additional deficiency in respect of the same taxable year, except in the case of fraud, and except as provided in subsection (e) of this section, relating to assertion of greater deficiencies before the Board, or in section 273 (c), relating to the making of jeopardy assessments. If the taxpayer is notified that, on account of a mathematical error appearing upon the face of the return, an amount of tax in excess of that shown upon the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical error, such notice shall not be considered (for the purposes of this subsection, or of subsection (a) of this section, prohibiting assessment and collection until notice of deficiency has been mailed, or of section 322 (c), prohibiting credits or refunds after petition to the Board of Tax Appeals) as a notice of a deficiency, and the taxpayer shall have no right to file a petition with the Board based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section.

(*g*) *Jurisdiction over other taxable years.*—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

(*h*) *Final decisions of Board.*—For the purposes of this title the date on which a decision of the Board becomes final shall be determined according to the provisions of section 1005 of the Revenue Act of 1926.

(*i*) *Prorating of deficiency to installments.*—If the taxpayer has elected to pay the tax in installments and a deficiency has been assessed, the deficiency shall be prorated to the four installments. Except as provided in section 273 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be collected at the same time as and as part of such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived, shall be paid upon notice and demand from the collector.

(*j*) *Extension of time for payment of deficiencies.*—Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date prescribe for the payment thereof will result in undue hardship to the taxpayer the Commissioner, under regulations prescribed by the Commissioner, with the approval of the Secretary, may grant an extension for the payment of such deficiency for a period not in excess of eighteen months, and, in exceptional cases, for a further period not in excess of twelve months. If an extension is granted, the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount of the deficiency, and with such sureties, as the Commissioner deems necessary, conditioned upon the payment of the deficiency in accordance with the terms of the extension. No extension shall be granted if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

(*k*) *Address for notice of deficiency.*—In the absence of notice to the Commissioner under section 312 (a) of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by this title, if mailed to the taxpayer at his last known address, shall be sufficient for the purposes of this title even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

ART. 272–1. *Assessment of a deficiency.*—If the Commissioner determines that there is a deficiency in respect of the income tax imposed by Title I (see sections 57 and 271), the Commissioner is authorized to notify the taxpayer of the deficiency by registered mail. If a joint return has been filed by husband and wife the Commissioner may, unless he has been notified by either spouse that a separate residence has been established, send either a joint or separate notice of deficiency. If, however, the Commissioner has been so notified, a separate notice of deficiency, that is, a duplicate original of the joint notice, must be sent by registered mail to each spouse at his or her last known address. The notice to the Commissioner provided for in the first paragraph of section 272 (a), relating to separate residences, should be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the attention of the Income Tax Unit, Records Division. Within 90 days after notice of the deficiency is mailed, as provided in section 272 (a), a petition may be filed with the Board of Tax Appeals for a redetermination of the deficiency. In determining such 90-day period, Sunday or a legal holidy in the District of Columbia is not to be counted as the ninetieth day. Except as stated in paragraphs (1), (2), (3), (4), and (5) of this article, no assessment of a deficiency in respect of a tax imposed by Title I shall be made until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. As to the date on which a decision of the Board becomes final, see section 1005 of the Revenue Act of 1926 (paragraph 16 of the Appendix to these regulations).

(1) If a taxpayer is notified of an additional amount of tax due on account of a mathematical error appearing upon the face of the return, such notice is not to be considered as a notice of a deficiency, and the taxpayer has no right to file a petition with the Board upon the basis of such notice, nor is the assessment of such additional tax prohibited by the provisions of section 272 (a).

(2) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, such deficiency shall be assessed immediately, as provided in section 273. (See article 273–1.)

(3) Upon the adjudication of bankruptcy of any taxpayer or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency determined by the Commissioner in respect of the tax shall be assessed immediately, irrespective of the provisions of section 272 (a), if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver. (See sections 274 and 298 and articles 274–1 and 274–2.)

(4) (*a*) If the Board renders a decision and determines that there is a deficiency, and, if the taxpayer duly files a petition for review of the decision by a circuit court of appeals (or the United States Court of Appeals for the District of Columbia), the filing of the petition will not operate as a stay of the assessment of any portion of the deficiency determined by the Board unless he has filed a bond with the Board as provided in section 1001 (c) of the Revenue Act of 1926, as amended (paragraph 13 of the Appendix to these regulations). If in such a case the necessary bond has not been filed by the taxpayer on or before the time his petition for review is filed, the amount determined by the Board as the deficiency will be assessed immediately after the filing of such petition.

(*b*) If the Commissioner files a petition for review and (1) if the taxpayer has not filed a petition for review within three months after the decision of the Board is rendered, or (2) if such petition has been filed by the taxpayer, but the necessary bond referred to in section 1001 (c) of the Revenue Act of 1926, as amended, has not been filed with

the Board on or before the time his petition for review is filed, the amount determined by the Board as the deficiency will be assessed in the case of (1), immediately after the expiration of the 3-month period, and in the case of (2), immediately after the filing of the petition for review by the taxpayer.

(5) The taxpayer may at any time by a signed notice in writing filed with the Commissioner waive the restrictions on the assessment of the whole or any part of the deficiency. The notice must in all cases be filed with the Commissioner. The filing of such notice with the Board does not constitute filing with the Commissioner within the meaning of the Act. After such waiver has been acted upon by the Commissioner and the assessment has been made in accordance with its terms, the waiver cannot be withdrawn.

If a petition is filed with the Board, the taxpayer should notify the Commissioner that the petition has been filed, in order to prevent an assessment by the Commissioner of the amount determined to be the deficiency. If no petition is filed with the Board within the period prescribed, the Commissioner shall assess the amount determined by him as the deficiency and of which he has notified the taxpayer by registered mail. In such case the Commissioner will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered mail. Where a petition is filed with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed by the Commissioner. If the Commissioner mails to the taxpayer notice of a deficiency, and the taxpayer files a petition with the Board within the prescribed period, the Commissioner is barred from determining any additional deficiency for the same taxable year except in the case of fraud and except as provided in section 272 (e) relating to the assertion of greater deficiencies before the Board or in section 273 relating to jeopardy assessments.

ART. 272–2. *Collection of a deficiency.*—Where a deficiency as redetermined by a decision of the Board which has become final is assessed, or where the taxpayer has not filed a petition and the deficiency as determined by the Commissioner has been assessed, the amount so assessed shall be paid upon notice and demand from the collector. As to cases coming within the provisions of paragraphs (2), (3), and (4) of article 272–1, see sections 273 (i) and 298 of the Revenue Act of 1938 and 1001 (c) of the Revenue Act of 1926, as amended (paragraph 13 of the Appendix to these regulations). As to interest on deficiencies, see section 292.

ART. 272–3. *Extension of time for payment of a deficiency.*—If it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date or dates prescribed for the payment thereof will result in undue hardship to the taxpayer, the Commissioner may grant an extension of time for the payment of the deficiency or any part thereof for a period not in excess of 18 months, and in exceptional cases for a further period not in excess of 12 months. The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, due to the sale of property at a sacrifice price, will result to the taxpayer from making payment of the deficiency at the due date. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship. The Act provides that no extension will be granted where the deficiency is due to negligence or intentional disregard of rules and regulations or to fraud with intent to evade tax.

An application for an extension of time for the payment of a deficiency should be made under oath on Form 1127 and must be accompanied or supported by evidence showing the undue hardship that would result to the taxpayer if the extension were refused. A sworn statement of assets and liabilities of the taxpayer and an itemized statement under oath showing all receipts and disbursements for each of the three months immediately preceding the month in which falls the date prescribed for the payment of the deficiency are required and should accompany the application. The application, with the evidence, must be filed with the collector, who will transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined and, if possible, within 30 days will be denied, granted, or tentatively granted subject to certain conditions of which the taxpayer will be notified. The Commissioner will not consider an application for an extension of time for the payment of a deficiency unless request therefor is made to the collector on or before the date prescribed for payment thereof, as shown by the notice and demand from the collector, or on or before the date or dates prescribed for payment in any prior extension granted.

As a condition to the granting of such an extension, the Commissioner will usually require the taxpayer to furnish a bond on Form 1127B in an amount not exceeding double the amount of the deficiency or to furnish other security satisfactory to the Commissioner for the payment of the liability on or before the date or dates prescribed for payment in the extension, so that the risk of loss to the Government will not be greater at the end of the extension period than it was at the beginning of the period. If a bond is required it shall be conditioned upon the payment of the deficiency, interest, and additional amounts assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of bonds or notes of the United States as provided in section 1126 of the Revenue Act of 1926, as amended by the Act entitled "An Act to amend the second Liberty Bond Act, as amended, and for other purposes," approved February 4, 1935 (49 Stat. 20). The amount of the deficiency and additions thereto shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the collector. Payment of the deficiency and additions thereto before the expiration of the extension will not relieve the taxpayer from paying the entire amount of interest provided for in the extension. (See section 296.)

SEC. 273. *Jeopardy assessments.*—(a) *Authority for making.*—If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) and notice and demand shall be made by the collector for the payment thereof.

(b) *Deficiency letters.*—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 272 (a), then the Commissioner shall mail a notice under such subsection within sixty days after the making of the assessment.

(c) *Amount assessable before decision of Board.*—The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 272 (f) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Board of Tax Appeals. The Commissioner may, at any time before the decision of the Board is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Commissioner shall notify the Board of the amount of such assessment, or abatement, if the petition is filed with the Board before the making of the assessment or is subsequently filed, and the Board shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) *Amount assessable after decision of Board.*—If the jeopardy assessment is made after the decision of the Board is rendered, such assessment may be made only in respect of the deficiency determined by the Board in its decision.

(e) *Expiration of right to assess.*—A jeopardy assessment may not be made after the decision of the Board has become final, or after the taxpayer has filed a petition for review of the decision of the Board.

(f) *Bond to stay collection.*—When a jeopardy assessment has been made the taxpayer, within 10 days after notice and demand from the collector for the payment of the amount of the assessment, may obtain a stay

of collection of the whole or any part of the amount of the assessment by filing with the collector a bond in such amount, not exceeding double the amount as to which the stay is desired, and with such sureties, as the collector deems necessary, conditioned upon the payment of so much of the amount, the collection of which is stayed by the bond, as is not abated by a decision of the Board which has become final, together with interest thereon as provided in section 297. If any portion of the jeopardy assessment is abated by the Commissioner before the decision of the Board is rendered, the bond shall, at the request of the taxpayer, be proportionately reduced.

(*g*) *Same—Further conditions.*—If the bond is given before the taxpayer has filed his petition with the Board under section 272 (a), the bond shall contain a further condition that if a petition is not filed within the period provided in such subsection, then the amount the collection of which is stayed by the bond will be paid on notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 per centum per annum from the date of the jeopardy notice and demand to the date of notice and demand under this subsection.

(*h*) *Waiver of stay.*—Upon the filing of the bond the collection of so much of the amount assessed as is covered by the bond shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the whole or any part of the amount covered by the bond, and if as a result of such waiver any part of the amount covered by the bond is paid, then the bond shall, at the request of the taxpayer, be proportionately reduced. If the Board determines that the amount assessed is greater than the amount which should have been assessed, then when the decision of the Board is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(*i*) *Collection of unpaid amounts.*—When the petition has been filed with the Board and when the amount which should have been assessed has been determined by a decision of the Board which has become final, then any unpaid portion, the collection of which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 322, without the filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference shall be assessed and shall be collected as part of the tax upon notice and demand from the collector.

(*j*) *Claims in abatement.*—No claim in abatement shall be filed in respect of any assessment in respect of any tax imposed by this title.

ART. 273–1. *Jeopardy assessments.*—If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he is required to assess such deficiency immediately, together with the interest and other additional amounts provided by law. If a deficiency is assessed on account of jeopardy after the decision of the Board of Tax Appeals is rendered, the jeopardy assessment may be made only with respect to the deficiency determined by the Board. The Commissioner is prohibited from making a jeopardy assessment after a decision of the Board has become final (see section 1005 of the Revenue Act of 1926, paragraph 16 of the Appendix to these regulations) or after the taxpayer has filed a petition for review of the decision of the Board.

If notice of a deficiency was mailed to the taxpayer (see section 272 (a)) before it was discovered that delay would jeopardize the assessment or collection of the tax, a jeopardy assessment may be made in an amount greater or less than that included in the deficiency notice. On the other hand if the assessment on account of jeopardy was made without mailing the notice required by section 272 (a), the Commissioner must within 60 days after the making of the assessment send the taxpayer notice of the deficiency by registered mail. The taxpayer may file a petition with the Board for a redetermination of the amount of the deficiency within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) after such notice is mailed. The Commissioner may, at any time before the decision of the Board is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. If the petition of the taxpayer is filed with the Board, either before or after the making of the jeopardy assessment, the Commissioner is required to notify the Board of such assessment or abatement, and the Board has jurisdiction to redetermine the amount of the deficiency together with all other amounts assessed at the same time in connection therewith. (See section 273 (c).)

After a jeopardy assessment has been made, the list showing such assessment will be immediately transmitted to the collector. Upon receipt of the list containing the assessment, the collector is required to send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has filed a petition with the Board, he is required to make payment of the amount of such assessment (to the extent that it has not been abated) within 10 days after the sending of notice and demand by the collector, unless before the expiration of such 10-day period he files with the collector a bond on Form 1129 of the character hereinafter prescribed. The bond must be in such amount, not exceeding double the amount for which the stay is desired, as the collector deems necessary and must be executed by sureties satisfactory to the collector. It must be conditioned upon the payment of so much of the amount included therein as is not abated by a decision of the Board which has become final, together with the interest on such amount provided for in section 297. If the bond is given before the taxpayer has filed his petition with the Board, it must contain a further condition that if a petition is not filed before the expiration of the 90-day period provided for the filing of such petition, the amount stayed by the bond will be paid upon notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of the notice and demand made after the expiration of the 90-day period. If a petition is not filed with the Board within the 90-day period, the collector will be so advised, and, if collection of the deficiency has been stayed by the filing of a bond within 10 days after the date of jeopardy notice and demand, he should then give notice and make demand for payment of the amount assessed plus interest. Any bond filed after the expiration of 10 days from the date of the jeopardy notice and demand is not such a bond as is contemplated by section 273 (f), and, while the collector may in his discretion accept the bond and stay collection of the deficiency, the taxpayer will not be relieved from payment of interest on the amount of the deficiency at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of payment.

Upon the filing of a bond of the character described within 10 days after the date of notice and demand for payment of the amount assessed, the collection of so much thereof as is covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result of such waiver any part of the amount covered by the bond is paid, or if any portion of the jeopardy assessment is abated by the Commissioner before the decision of the Board is rendered, then the bond shall at the request of the taxpayer be proportionately reduced. If the Board determines that the amount assessed is greater than the correct amount of the tax, the bond will also be proportionately reduced at the request of the taxpayer after the Board renders its decision.

After the Board has rendered its decision and such decision has become final, the collector will be notified of the action taken. The collector will then send notice and demand for the unpaid portion of the amount determined by the Board, the collection of which has been stayed by the bond. The collector is required to include in the notice and demand for the unpaid portion, interest at the rate of 6 percent per annum from the date of the jeopardy notice and demand to the date of the notice and demand referred to in this paragraph. If the amount of the jeopardy assessment is less than the amount determined by the Board, the difference, together with interest as provided in section 292, will be assessed, and collected as part of the tax upon notice and demand from the collector. If the amount included in the notice and demand made after the decision of the Board is not paid within 10 days after such notice

and demand, there shall be collected as part of the tax, interest as provided in section 294 (b). If the amount of the jeopardy assessment is in excess of the amount determined by the Board, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 322.

As to bankruptcy, proceedings for the relief of debtors and receivership cases, see sections 274 and 298 and articles 274–1 and 274–2.

SEC. 274. *Bankruptcy and receiverships.*—(a) *Immediate assessment.*—Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner in respect of a tax imposed by this title upon such taxpayer shall, despite the restrictions imposed by section 272 (a) upon assessments be immediately assessed if such deficiency has not theretofore been assessed in accordance with law. In such cases the trustee in bankruptcy or receiver shall give notice in writing to the Commissioner of the adjudication of bankruptcy or the appointment of the receiver, and the running of the statute of limitations on the making of assessments shall be suspended for the period from the date of adjudication in bankruptcy or the appointment of the receiver to a date 30 days after the date upon which the notice from the trustee or receiver is received by the Commissioner; but the suspension under this sentence shall in no case be for a period in excess of two years. Claims for the deficiency and such interest, additional amounts and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the Board; but no petition for any such redetermination shall be filed with the Board after the adjudication of bankruptcy or the appointment of the receiver.

(b) *Unpaid claims.*—Any portion of the claim allowed in such bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand from the collector after the termination of such proceeding, and may be collected by distraint or proceeding in court within six years after termination of such proceeding. Extensions of time for such payment may be had in the same manner and subject to the same provisions and limitations as are provided in section 272 (j) and section 296 in the case of a deficiency in a tax imposed by this title.

ART. 274–1. *Bankruptcy and receivership proceedings.*—During a bankruptcy proceeding, or an equity receivership proceeding in either a Federal or a State court, the assets of the taxpayer are in general under the control of the court in which such proceeding is pending, and the collection of taxes cannot be made by distraining upon such assets. However, any assets which under applicable provisions of law are not under the control of the court may be subject to distraint.

As used in these regulations the term "bankruptcy proceeding" includes proceedings under Chapters I to VII of the Bankruptcy Act, as amended, or under section 74, 75, 77, or 77B, or Chapters X to XIII, of such Act, as amended; and the term "adjudication of bankruptcy" includes, in addition to an adjudication in a proceeding under Chapters I to VII, the approval of a petition as properly filed under section 77 or 77B or Chapter X by a court of competent jurisdiction or the filing of a petition under section 74 or 75 or Chapters XI to XIII with a court of competent jurisdiction.

A trustee in bankruptcy (including a trustee, receiver, debtor in possession, or other person designated as in control of the assets of a debtor in any bankruptcy proceeding by order of the court in which such proceeding is pending) or a receiver in any receivership proceeding is required to give notice in writing to the Commissioner of Internal Revenue in Washington, D. C., of the adjudication of bankruptcy or the appointment of a receiver. (See section 274 (a) and article 275–1.)

Collectors should, promptly after notice of outstanding liability against a taxpayer in any bankruptcy or receivership proceedings, and in any event within the time limited by the appropriate provisions of the Bankruptcy Act, as amended, and the orders of the court in which such proceeding is pending, file claim covering such liability in the court in which such proceeding is pending. Such claim should be filed whether the unpaid taxes involved have been assessed or not, except in cases where the departmental instructions direct otherwise; for example, where the payment of the taxes is secured by a sufficient bond. Such claim should cover the amount represented by the assessment, plus interest at the rate of 6 percent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding or to the date of payment if payment is made in full prior to such termination. At the same time claim is filed with the bankruptcy or receivership court, the collector will send notice and demand for payment to the taxpayer together with a copy of such claim.

Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended (paragraphs 47 and 48, respectively, of the Appendix to these regulations), and section 64 of the Bankruptcy Act, as amended, taxes are entitled to the priority over other claims therein stated and the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which bankruptcy or receivership proceeding is pending, may be held personally liable for failure on his part to protect the priority of the Government respecting taxes of which he has notice. Bankruptcy courts have jurisdiction under the Bankruptcy Act, as amended, to determine all disputes regarding the amount and validity of taxes of a bankrupt or of a debtor in a proceeding under the Bankruptcy Act, as amended. A bankruptcy or receivership proceeding does not discharge any portion of a claim of the United States for taxes except in the case of a proceeding under Chapter X of the Bankruptcy Act, as amended, and except to the extent which may be provided in a plan or arrangement duly effectuated in a bankruptcy proceeding; and any portion of a claim of the United States for taxes which has been allowed by the court in which the bankruptcy or receivership proceeding is pending and which remains unsatisfied after the termination of the bankruptcy or receivership proceeding shall be collected with interest as provided in section 298.

ART. 274–2. *Immediate assessments in bankruptcy and receivership cases.*—If the Commissioner has determined that a deficiency is due in respect of income tax and the taxpayer has filed a petition with the Board of Tax Appeals prior to the adjudication of bankruptcy or the appointment of a receiver, the trustee, receiver, debtor in possession, or other person designated as in control of the assets of the debtor by the court in which the bankruptcy or receivership proceeding is pending, may prosecute the taxpayer's appeal before the Board as to that particular determination. No petition shall be filed with the Board for a redetermination of the deficiency after the adjudication of bankruptcy or the appointment of a receiver.

Claim for the amount of a deficiency, even though pending before the Board for consideration, may be filed with the court in which the bankruptcy or receivership proceeding is pending without awaiting final decision of the Board. In case of final decision of the Board before the termination of the bankruptcy, debtor, or receivership proceeding, a copy of the Board's decision may be filed by the Commissioner with the court in which such proceeding is pending.

While the Commissioner is required by section 274 to make immediate assessment of any deficiency, such assessment is not made as a jeopardy assessment within the meaning of section 273, and consequently the provisions of that section do not apply to any assessment made under section 274. Therefore, the notice of the deficiency provided for in section 273 (b) will not be mailed. Although such notice will not be issued, nevertheless a letter will be sent to the taxpayer, or to the trustee, receiver, debtor in possession, or other person designated by the court in which the bankruptcy or receivership proceeding is pending as in control of the assets of the debtor, notifying him in detail how the deficiency was computed, that he may furnish evidence showing wherein the deficiency is incorrect, and that upon request he will be granted a hearing with respect to such deficiency. If after such evidence is submitted and hearing held

any adjustment appears necessary in the deficiency, appropriate action will be taken. A copy of the notification letter will be attached to the assessment list as the collector's authority for filing claim in any bankruptcy or receivership proceeding.

If any portion of the claim allowed by the court in a bankruptcy or receivership proceeding remains unpaid after the termination of such proceeding, the collector will send notice and demand for payment thereof to the taxpayer. Such unpaid portion with interest as provided in section 298 may be collected from the taxpayer by distraint or proceeding in court within six years after the termination of the bankruptcy or receivership proceeding. Extensions of time for the payment of such unpaid amount may be granted in the same manner and subject to the same provisions and limitations as provided in sections 272 (j) and 297. (See article 272–3.)

This article deals only with immediate assessments provided for in section 274 and the procedure in connection with such assessments.

SEC. 275. *Period of limitation upon assessment and collection.*—Except as provided in section 276—

(*a*) *General rule.*—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(*b*) *Request for prompt assessment.*—In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of three years after the return was filed. This subsection shall not apply in the case of a corporation unless—

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such 18 months' period; and

(2) The dissolution is in good faith begun before the expiration of such 18 months' period; and

(3) The dissolution is completed.

(*c*) *Omission from gross income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

(*d*) *Shareholders of foreign personal holding companies.*—If the taxpayer omits from gross income an amount properly includible therein under section 337 (b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the undistributed Supplement P net income of a foreign personal holding company) the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within seven years after the return was filed.

(*e*) *Distributions in liquidation to shareholders.*—If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within four years after the return was filed.

(*f*) For the purposes of subsections (a), (b), (c), (d), and (e), a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

(*g*) *Corporation and shareholder.*—If a corporation makes no return of the tax imposed by this title, but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

SEC. 276. *Same—Exceptions.*—(*a*) *False return or no return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(*b*) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(*c*) *Collection after assessment.*—Where the assessment of any income tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

SEC. 277. *Suspension of running of statute.*—The running of the statute of limitations provided in section 275 or 276 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under section 272 (a)) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for sixty days thereafter.

ART. 275–1. *Period of limitation upon assessment of tax.*—The amount of income tax imposed by the Act must be assessed within three years after the return was filed. For the purposes of subsections (a), (b), (c), (d), and (e) of section 275, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. Exceptions to the period of limitation stated in this paragraph (other than those provided for elsewhere than in the internal revenue laws) are as follows:

(1) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation contemplating dissolution, the tax shall be assessed within 18 months after written request therefor by the fiduciary or legal representative of the estate of the decedent or by the corporation, but not after the expiration of 3 years after the return was filed. The effect of this provision is to limit the period in which the Commissioner may assess the tax in such cases to a period of 18 months from the date the request is filed, even though more than 18 months still remain of the regular 3-year period in which the assessment may under ordinary circumstances be made. The request, in order to be effective, must be made after the return is filed and must be in such language as to make it clear to the Commissioner that it is desired to take advantage of the provisions of section 275 (b). In the case of a corporation the 18-month period of limitation shall not apply unless—

(*a*) the written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such period,

(*b*) the dissolution is in good faith begun before the expiration of such period, and

(*c*) the dissolution so begun is completed either before or after the expiration of such 18-month period.

Such a request does not have the effect of extending the regular period of limitation even though the request is made less than 18 months before the expiration of the regular period of limitation.

(2) If a corporation makes no income tax return under the Act, but each of the shareholders includes in his personal return his distributive share of the net income of the corporation, the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

(3) In the case of a false or fraudulent return with intent to evade tax, the tax may be assessed at any time after such false or fraudulent return is filed.

(4) If there is omitted from the gross income stated in the return an amount properly includible therein which is in excess of 25 percent of the gross income so stated, the tax may be assessed at any time within five years after the return was filed.

(5) In the event the taxpayer fails to file a return, the amount of tax due may be assessed at any time after the date prescribed for filing the return. (But see paragraph (2) of this article.)

(6) If the taxpayer omits from gross income an amount properly includible therein under section 337 (b) as his distributive share of the undistributed Supplement P net income of a foreign personal holding company, the tax may be assessed at any time within seven years after the return was filed.

(7) If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an

amount distributed in liquidation of a corporation, other than a foreign personal holding company, the tax may be assessed at any time within four years after the return was filed.

(8) If before the expiration of the time prescribed in section 275 for the assessment of the tax the Commissioner and the taxpayer have consented in writing to the assessment of the tax after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(9) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a), then the running of the statute of limitations on assessment of any deficiency shall be suspended for the period during which the Commissioner is prohibited from making the assessment (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter. If the Commissioner mails to a taxpayer a notice of deficiency within the statutory period of limitation and the taxpayer does not appeal therefrom to the Board, the notice of deficiency so given does not suspend the running of the period of limitation on assessment for the purpose of any additional deficiency shown to be due in a subsequent deficiency notice.

(10) In a bankruptcy or receivership proceeding the running of the statute of limitations on the making of assessments is suspended from the date of adjudication in bankruptcy or the date of the appointment of a receiver, as the case may be, to a date 30 days after the date upon which the notice provided for in section 274 (a) is received by the Commissioner in Washington, D. C., but in no case shall the suspension be for a period in excess of two years. See section 274 (a) and articles 274–1 and 274–2.

With respect to the period of limitation for assessing the amount of the liability of a transferee of property, or for assessing the amount of the liability of a fiduciary under section 3467 of the Revised Statutes, as amended (paragraph 48 of the Appendix to these regulations), see section 311.

ART. 275–2. *Period of limitation upon collection of tax.*—In the case of the income taxes imposed by the Act, a proceeding in court without assessment for the collection of such tax must be begun within three years after the return was filed.

The exceptions to the period of limitation upon collection of the tax without assessment stated in the preceding paragraph are as follows:

(1) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation, a proceeding in court for the collection of the tax without assessment must be begun within 18 months after a written request therefor by the executor, administrator, or other fiduciary representing the estate of the decedent or by the corporation, but not after the expiration of 3 years after the return was filed. Such a request does not have the effect of extending the regular period of limitation within which a proceeding in court without assessment may be begun, even though the request is made less than 18 months before the expiration of the regular period of limitation, nor is it of any effect if made before the return is filed. In the case of a corporation the conditions stated in (*a*), (*b*), and (*c*) of paragraph (1) of article 275–1 also must be met.

(2) A proceeding in court for the collection of the tax without assessment may be begun at any time—

(*a*) In case the taxpayer files a false or fraudulent return with intent to evade tax; and

(*b*) In case the taxpayer failed to file a return.

(3) If there is omitted from the gross income stated in the return an amount properly includible therein which is in excess of 25 percent of the gross income so stated, a proceeding in court for the collection of the tax may be begun without assessment at any time within five years after the return was filed.

(4) If the taxpayer omits from gross income an amount properly includible therein under section 337 (b) as his distributive share of the undistributed Supplement P net income of a foreign personal holding company, a proceeding in court for the collection of the tax may be begun without assessment at any time within seven years after the return was filed.

(5) If the taxpayer omits from gross income an amount properly includible therein under section 115 (c) as an amount distributed in liquidation of a corporation, other than a foreign personal holding company, a proceeding in court for the collection of the tax may be begun without assessment at any time within four years after the return was filed.

In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years after the assessment thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such 6-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see article 272–1), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court after assessment or without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

With respect to the period of limitation upon the collection of the tax on unpaid claims in bankruptcy or receivership proceedings, see section 274 (b) and article 274–2.

CHAPTER XXXI

Interest and Additions to Tax

Supplement M—Interest and Additions to the Tax

SEC. 291. *Failure to file return.*—In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

ART. 291–1. *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, a certain percent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. The amount to be added to the tax is 5 percent if the failure is for not more than 30 days, with an additional 5 percent for each addi-

tional 30 days or fraction thereof during which failure continues, not to exceed 25 percent in the aggregate. Two classes of delinquents are subject to this addition to the tax:

(*a*) Those who do not file returns and for whom returns are made by a collector, a deputy collector, or the Commissioner, and

(*b*) Those who file tardy returns and are unable to show reasonable cause for the delay.

A taxpayer who files a tardy return and wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause, and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.

If the addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

For addition to the tax in case of a deficiency due to fraud with intent to evade tax, see section 293. As to the making of returns for taxpayers by collectors or the Commissioner in the case of delinquency in filing a return, or in the case of a false or fraudulent return, see section 3176 of the Revised Statutes, as amended (paragraph 65 of the Appendix to these regulations).

SEC. 292. *Interest on deficiencies.*—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272 (d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier.

SEC. 293. *Additions to the tax in case of deficiency.*—(*a*) *Negligence.*—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

(*b*) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

SEC. 294. *Additions to the tax in case of nonpayment.*—(*a*) *Tax shown on return.*—(1) *General rule.*—Where the amount determined by the taxpayer as the tax imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 6 per centum per annum from the date prescribed for its payment until it is paid.

(2) *If extension granted.*—Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, and the amount the time for payment of which has been extended, and the interest thereon determined under section 295, is not paid in full prior to the expiration of the period of the extension, then, in lieu of the interest provided for in paragraph (1) of this subsection, interest at the rate of 6 per centum per annum shall be collected on such unpaid amount from the date of the expiration of the period of the extension until it is paid.

(*b*) *Deficiency.*—Where a deficiency, or any interest or additional amounts assessed in connection therewith under section 292, or under section 293, or any addition to the tax in case of delinquency provided for in section 291, is not paid in full within ten days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 6 per centum per annum from the date of such notice and demand until it is paid. If any part of a deficiency prorated to any unpaid installment under section 272 (i) is not paid in full on or before the date prescribed for the payment of such installment, there shall be collected as part of the tax interest upon the unpaid amount at the rate of 6 per centum per annum from such date until it is paid.

(*c*) *Filing of jeopardy bond.*—If a bond is filed, as provided in section 273, the provisions of subsection (b) of this section shall not apply to the amount covered by the bond.

SEC. 295. *Time extended for payment of tax shown on return.*—If the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, is extended under the authority of section 56 (c), there shall be collected as a part of such amount, interest thereon at the rate of 6 per centum per annum from the date when such payment should have been made if no extension had been granted, until the expiration of the period of the extension.

SEC. 296. *Time extended for payment of deficiency.*—If the time for the payment of any part of a deficiency is extended, there shall be collected, as a part of the tax, interest on the part of the deficiency the time for payment of which is so extended, at the rate of 6 per centum per annum for the period of the extension, and no other interest shall be collected on such part of the deficiency for such period. If the part of the deficiency the time for payment of which is so extended is not paid in accordance with the terms of the extension, there shall be collected, as a part of the tax, interest on such unpaid amount at the rate of 6 per centum per annum for the period from the time fixed by the terms of the extension for its payment until it is paid, and no other interest shall be collected on such unpaid amount for such period.

SEC. 297. *Interest in case of jeopardy assessments.*—In the case of the amount collected under section 273 (i) there shall be collected at the same time as such amount, and as a part of the tax, interest at the rate of 6 percentum per annum upon such amount from the date of the jeopardy notice and demand to the date of notice and demand under section 273 (i), or, in the case of the amount collected in excess of the amount of the jeopardy assessment, interest as provided in section 292. If the amount included in the notice and demand from the collector under section 273 (i) is not paid in full within ten days after such notice and demand, then there shall be collected, as part of the tax, interest upon the unpaid amount at the rate of 6 per centum per annum from the date of such notice and demand until it is paid.

SEC. 298. *Bankruptcy and receiverships.*—If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within ten days from the date of notice and demand from the collector, then there shall be collected as a part of such amount interest upon the unpaid portion thereof at the rate of 6 per centum per annum from the date of such notice and demand until payment.

SEC. 299. *Removal of property or departure from United States.*—For additions to tax in case of leaving the United States or concealing property in such manner as to hinder collection of the tax, see section 146.

CHAPTER XXXII

Claims Against Transferees and Fiduciaries

Supplement N—Claims Against Transferees and Fiduciaries

SEC. 311. *Transferred assets.*—(*a*) *Method of collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.

(2) *Fiduciaries.*—The liability of a fiduciary under section 3467 of the Revised Statutes in respect of the payment of any such tax from the estate of the taxpayer.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(*b*) *Period of limitation.*—The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the taxpayer;

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer;—

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively,—then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) In the case of the liability of a fiduciary,—not later than one year after the liability arises or not later than the expiration of the period for collection of the tax

in respect of which such liability arises, whichever is the later;

(4) Where before the expiration of the time prescribed in paragraph (1), (2), or (3) for the assessment of the liability, both the Commissioner and the transferee or fiduciary have consented in writing to its assessment after such time, the liability may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) *Period for assessment against taxpayer.*—For the purposes of this section, if the taxpayer is deceased, or in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had death or termination of existence not occurred.

(d) *Suspension of running of statute of limitations.*—The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272 (a), be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for sixty days thereafter.

(e) *Address for notice of liability.*—In the absence of notice to the Commissioner under section 312 (b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this title, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this title even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(f) *Definition of "transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

ART. 311–1. *Claims in cases of transferred assets.*—The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, as amended, in respect of any income tax imposed by the Act (paragraph 48 of the Appendix to these regulations), whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by the Act, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with the Board of Tax Appeals, and the filing of a petition for review of the Board's decision, are included in the sections and articles relating to deficiencies in tax imposed by Title I.

The term "transferee" as used in this article includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

The period of limitation for assessment of the liability of a transferee or of a fiduciary, referred to in the first paragraph of this article, is as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer one year after the expiration of the period of limitation for assessment against the taxpayer (see sections 275–277);

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the preceding transferee, or three years after the expiration of the period of limitation for assessment against the taxpayer, whichever of the two periods (the 1-year period or the 3-year period) first expires;

(3) If a court proceeding against the taxpayer or last preceding transferee for the collection of the tax or liability in respect thereof, respectively, has been begun within the period of limitation for the bringing of such proceeding, then within one year after the return of execution in such proceeding; and

(4) In the case of the liability of a fiduciary, not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

(5) If before the expiration of the time prescribed in section 311 (b) (1), (2) or (3) for the assessment of the liability of a transferee or fiduciary, both the Commissioner and the transferee or fiduciary have consented in writing to the assessment of the liability after such time, the liability may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

For the purpose of determining the period of limitation for assessment against a transferee or a fiduciary, if the taxpayer is deceased, or, in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

If a notice of the liability of a transferee or the liability of a fiduciary has been mailed to such transferee or to such fiduciary under the provisions of section 272 (a), then the running of the statute of limitations shall be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

SEC. 312. *Notice of fiduciary relationship.*—(a) *Fiduciary of taxpayer.*—Upon notice to the Commissioner that any person is acting in a fiduciary capacity such fiduciary shall assume the powers, rights, duties, and privileges of the taxpayer in respect of a tax imposed by this title (except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayer), until notice is given that the fiduciary capacity has terminated.

(b) *Fiduciary of transferee.*—Upon notice to the Commissioner that any person is acting in a fiduciary capacity for a person subject to the liability specified in section 311, the fiduciary shall assume, on behalf of such person, the powers, rights, duties, and privileges of such person under such section (except that the liability shall be collected from the estate of such person), until notice is given that the fiduciary capacity has terminated.

(c) *Manner of notice.*—Notice under subsection (a) or (b) shall be given in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 312–1. *Fiduciaries.*—As soon as the Commissioner receives notice that a person is acting in a fiduciary capacity, such fiduciary must, except as otherwise specifically provided, assume the powers, rights, duties, and privileges of the taxpayer with respect to income tax imposed by Title I. If the person is acting as a fiduciary for a transferee or other person subject to the liability specified in section 311, such fiduciary is required to assume the powers, rights, duties, and privileges of the transferee or other person under that section. The amount of the tax or liability is ordinarily not collectible from the personal estate of the fiduciary but is collectible from the estate of the taxpayer or from the estate of the transferee or other person subject to the liability specified in section 311. The "notice to the Commissioner" provided for in section 312 shall be a written notice signed by the fiduciary and filed with the Commissioner. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for tax, and, if so, the year or years involved, or a liability at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary under section 3467 of the Revised Statutes, as amended (paragraph 48 of the Appendix to these regulations), in respect of the payment of any tax from the estate of the taxpayer. Any such written notice which has been filed with the Commissioner since the enactment of the Revenue Act of 1926 shall be considered as sufficient notice to the Commissioner within the meaning of section 312. Unless there is already on file with the Commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such

evidence must be filed with and made a part of the notice. If the fiduciary capacity exists by order of court, a certified copy of the order may be regarded as such satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary in order to be relieved of any further duty or liability as such, must file with the Commissioner written notice that the fiduciary capacity has terminated as to him, accompanied by satisfactory evidence of the termination of the fiduciary capacity. The notice of termination should state the name and address of the person, if any, who has been substituted as fiduciary.

If the notice of the fiduciary capacity described in the preceding paragraph is not filed with the Commissioner prior to the sending of notice of a deficiency by registered mail to the last known address of the taxpayer (see section 272 (a)), or the last known address of the transferee or other person subject to liability (see section 311), no notice of the deficiency will be sent to the fiduciary. In such a case the sending of the notice to the last known address of the taxpayer, transferee, or other person, as the case may be, will be a sufficient compliance with the requirements of the Act, even though such taxpayer, transferee, or other person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. Under such circumstances if no petition is filed with the Board of Tax Appeals before the expiration of 90 days from the sending of the notice to the taxpayer, transferee, or other person, the tax, or liability under section 311, will be assessed immediately upon the expiration of such 90-day period, and demand for payment will be made by the collector. The term "fiduciary" is defined in section 901 (a) (6) to mean a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

This article, relating to the provisions of section 312, shall not be taken to abridge in any way the powers and duties of fiduciaries provided for in other sections of the Act.

CHAPTER XXXIII

Overpayments

Supplement O—Overpayments

SEC. 321. *Overpayment of installment.*—If the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 322.

SEC. 322. *Refunds and credits.*—(a) *Authorization.*—Where there has been an overpayment of any tax imposed by this title, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(b) *Limitation on allowance.*—(1) *Period of limitation.*—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) *Limit on amount of credit or refund.*—The amount of the credit or refund shall not exceed the portion of the tax paid during the three years immediately preceding the filing of the claim, or, if no claim was filed, then during the three years immediately preceding the allowance of the credit or refund.

(c) *Effect of petition to Board.*—If the Commissioner has mailed to the taxpayer a notice of deficiency under section 272 (a) and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except—

(1) As to overpayments determined by a decision of the Board which has become final; and

(2) As to any amount collected in excess of an amount computed in accordance with the decision of the Board which has become final; and

(3) As to any amount collected after the period of limitation upon the beginning of distraint or a proceeding in court for collection has expired; but in any such claim for credit or refund or in any such suit for refund the decision of the Board which has become final, as to whether such period has expired before the notice of deficiency was mailed, shall be conclusive.

(d) *Overpayment found by Board.*—If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision that such portion was paid (1) within three years before the filing of the claim or the filing of the petition, whichever is earlier, or (2) after the mailing of the notice of deficiency.

(e) *Tax withheld at source.*—For refund or credit in case of excessive withholding at the source, see section 143 (f).

ART. 322–1. *Authority for abatement, credit, and refund of tax.*—Authority for the credit and refund of any overpayment of any income tax imposed by Title I is contained in section 322.

Section 273 (j) prohibits the filing of claims for abatement by taxpayers with respect to assessments of income tax imposed by Title I.

ART. 322–2. *Credit and refund adjustments.*—Overassessments and overpayments of income taxes will be adjusted by means of certificates of overassessment. Credits or refunds of overpayments on the basis of such certificates of overassessment may not be allowed or made, however, after the expiration of the statutory period of limitation properly applicable unless prior to the expiration of such period a claim therefor on Form 843 has been filed by the taxpayer. The claim, together with appropriate supporting evidence, must be filed in the office of the collector for the district in which the tax was paid. Where an amount of tax in excess of that properly due has been paid by a withholding agent, the credit or refund of such excess amount shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent. (See section 143 (f).) As to interest in case of credits or refunds, see section 614 of the Revenue Act of 1928, as amended by section 804 of the Revenue Act of 1936 (paragraph 42 of the Appendix to these regulations), and section 177, United States Judicial Code, as amended by section 615 of the Revenue Act of 1928 and section 808 of the Revenue Act of 1936 (paragraph 43 of the Appendix to these regulations).

ART. 322–3. *Claims for refund by taxpayers.*—Claims by the taxpayer for the refunding of taxes, interest, penalties, and additions to tax erroneously or illegally collected shall be made on Form 843, and should be filed with the collector of internal revenue. A separate claim on such form shall be made for each taxable year or period.

The claim must set forth in detail and under oath each ground upon which a refund is claimed, and facts sufficient to apprise the Commissioner of the exact basis thereof. No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed prior to the expiration of such period. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund. With respect to limitations upon the refunding or crediting of taxes, see article 322–7.

If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter a refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made in the claim showing that the return was filed by the fiduciary and that the latter is still acting. In such cases, if a refund or interest is to be paid, letters testamentary, letters of administration, or other evidence may be required, but should be submitted only upon the receipt of a specific request therefor. If a claim is filed by a fiduciary other than the one by whom the return was filed,

the necessary documentary evidence should accompany the claim. The affidavit may be made by the agent of the person assessed, but in such case a power of attorney must accompany the claim.

Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and may be sent to such persons in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks. The Commissioner may, however, send any such check direct to the claimant. In this connection, see section 3477 of the Revised Statutes, which provides:

SEC. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same.

The Commissioner has no authority to refund on equitable grounds penalties or other amounts legally collected. As to claims for refund of sums recovered by suit, see articles 322–4 to 322–6.

ART. 322–4. *Claim for payment of judgment obtained against collector.*—(*a*) A claim for the amount of a judgment against a collector of internal revenue for the recovery of taxes, penalties, or other sums should be made under oath, on Form 843, and filed directly with the Commissioner of Internal Revenue, Washington, D. C. Two certified copies of the final judgment and a certificate of probable cause should be attached to the claim. If the payment of court costs is claimed, an itemized bill of the court costs paid, receipted by the clerk of the court, should also accompany the claim. With respect to the certificate of probable cause, section 989 of the Revised Statutes provides:

SEC. 989. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.

If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

(*b*) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name, accompanied by two certified copies of the final judgment, and an itemized bill of the court costs paid. A certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, should accompany the claim. (See further article 322–3.)

ART. 322–5. *Claim for payment of judgment obtained in United States district court against the United States.*—A claim for the payment of a judgment rendered by a United States district court against the United States representing taxes, penalties, or other sums should be made under oath, on Form 843, in duplicate, and filed directly with the Commissioner of Internal Revenue, Washington, D. C. Two certified copies of the final judgment should be attached to the claim. If the judgment specifically provides for the recovery of costs, an itemized bill of such court costs paid, receipted by the clerk of the court, should also accompany the claim. If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

ART. 322–6. *Claim for payment of judgment obtained in the Court of Claims against the United States.*—A claim for the payment of a judgment rendered by the United States Court of Claims against the United States, representing taxes, penalties, or other sums should be made under oath, on Form 843, in duplicate, and filed directly with the Commissioner of Internal Revenue, Washington, D. C., accompanied by a certificate of judgment issued by the clerk of the court and two copies of the printed opinion of the court, if an opinion was rendered. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

ART. 322–7. *Limitations upon the crediting and refunding of taxes paid.*—(*a*) Unless a claim for credit or refund is filed within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, the Commissioner is prohibited from allowing or making a credit or refund of income tax imposed by Title I after both periods have expired. If no return is filed by the taxpayer, the Commissioner is prohibited from allowing or making a credit or refund of such tax after two years from the time the tax was paid unless before the expiration of such 2-year period a claim therefor is filed. The amount of the credit or refund in any case shall not exceed the portion of the tax paid during the 3-year period immediately preceding the date of the allowance of the credit or refund, or, if the credit or refund is based upon a claim, the amount of the credit or refund shall not exceed the portion of the tax paid during the 3-year period immediately preceding the date of filing such claim. The provisions of this paragraph are subject to the exceptions provided in paragraph (*b*) of this article.

(*b*) In any case where a person having a right to file a petition with the Board of Tax Appeals with respect to a deficiency in income tax imposed by the Act files such petition within the prescribed time, no credit or refund of the tax for the year to which the deficiency relates shall be allowed or made, and no suit for the recovery of any part of such tax shall be instituted by the taxpayer, except that—

(1) If the Board finds that there is no deficiency but that the person has overpaid his tax for the year to which the notice of deficiency relates, and the decision of the Board as to the amount overpaid has become final (see section 1005 of the Revenue Act of 1926), the overpayment shall be credited or refunded, but no such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision that such portion was paid (A) not earlier than three years before the filing of the refund claim therefor or the filing of the petition, whichever event occurs first in point of time, or if no claim is filed, not earlier than three years before the filing of the petition, or (B) after the mailing of the notice of deficiency.

(2) In the case of a jeopardy assessment made under section 273, if the amount which should have been assessed as determined by a decision of the Board

which has become final is less than the amount already collected, the excess payment shall be credited or refunded subject to a determination being made by the Board with respect to the time of payment as stated in (b) (1) of this article.

(3) If the amount of the deficiency determined by the Board (in a case where collection has not been stayed by the filing of a bond) is disallowed in whole or in part by the reviewing court, then the overpayment resulting from such disallowance shall be credited or refunded without the making of claim therefor subject to a determination being made by the Board with respect to the time of payment as stated in (b) (1) of this article. (See section 1001 (d) of the Revenue Act of 1926, as amended, paragraph 13 of the Appendix to these regulations.)

(4) Where the amount collected is in excess of the amount computed in accordance with the decision of the Board which has become final, the excess payment shall be credited or refunded within the period of limitation provided in section 322 (b).

(5) Where an amount is collected after the statutory period of limitation upon the beginning of distraint or a proceeding in court for collection has expired (see article 275–2), the taxpayer may file a claim for refund of the amount so collected within the period of limitation provided in section 322 (b). In any such case, the decision of the Board as to whether the statutory period upon collection of the tax expired before notice of the deficiency was mailed shall, when the decision becomes final, be conclusive.

ART. 322–8. *Crediting of accounts of collectors in cases of assessments against several persons covering same liability.*— If assessments have been made against several persons covering the same tax liability, and payment of such liability by one or more of such persons has been duly certified to the Commissioner, the Commissioner, for the purpose of temporarily relieving the collector from liability under section 3218 of the Revised Statutes, may authorize him to take credit temporarily with respect to the assessments not specifically paid. Such action, however, shall not constitute an abatement and shall not discharge the liability of the persons concerned.

* * * * *

[*Chapters XXXIV–XXXVIII and the Appendix will appear in the "Federal Register" for Tuesday, February 14, 1939.*]

[SEAL] GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved: February 7, 1939.

H. MORGENTHAU, JR.,
Secretary of the Treasury.

[F. R. Doc. 39–450; Filed, February 7, 1939; 4: 01 p. m.]

TITLE 30—MINERAL RESOURCES

NATIONAL BITUMINOUS COAL COMMISSION

[General Docket No. 15]

ESTABLISHMENT OF MINIMUM PRICES AND MARKETING RULES AND REGULATIONS

CORRECTION OF ERRORS IN SCHEDULES OF APPROVED MINIMUM PRICES FOR DISTRICTS NOS. 7 AND 8

Order

It appearing that in the schedule of minimum prices approved by the Commission for District No. 7,[1] being the Appendix to the Findings of the Commission in the above-entitled matter, the coal of the Carter Coal Company in Size Group #5 produced at the Caretta #5 Mine, #4 Sub-district, in the War Creek Seam, by reason of a typographical error, was classified as "A" instead of Class "D," as originally proposed by the Board and as found by the Commission, and

It further appearing that in the schedule of minimum prices approved by the Commission for District No. 8,[2] being the Appendix to the Findings of the Commission for District No. 8, the coal of the West Virginia Coal and Coke Corporation's Earling Mine in Size Group 26, by reason of a typographical error, was classified "G" instead of "J" as the same was modified by the Commission in its Findings entered herein, and

It further appearing that in said schedule of minimum prices for District No. 8, the coals of the Ajax Coal Company in Size Groups 21 to 25, both inclusive, were classified as "k" instead of "L," as modified by the Commission in its Fndings, and

It further appearing that in the said schedule of minimum prices for District No. 8, the coals of the Red Jacket Coal Corporation in Size Group 26, by reason of typographical errors, were given no classification, although the Commission found that these coals should be classified as follows: Mitchell Branch Mine, "J"; Junior Mine, "K"; # 5 Mine, "N"; # 6 Mine, "F"; # 32 Top Mine, "M"; and # 32 Bottom Mine, "K."

Now, therefore, It is ordered that the schedule of minimum prices approved by the Commission for District No. 7, to serve as the basis for coordination, be and the same is hereby corrected by changing the classification therein appearing for Size Group 5 of the Caretta Mine of the Carter Coal Company from Class "A" to Class "D," and

It is further ordered that the schedule of minimum prices approved by the Commission for District No. 8, to serve as a basis for coordination, be corrected in the following respects:

The classification of the West Virginia Coal and Coke Corporation's Earling Mine in Size Group 26 be and the same is hereby changed from "G" to "J."

The classification of Size Groups 21 to 25, both inclusive, produced at the Ajax Mine of the Ajax Coal Company, be and the same are hereby changed from Classification "K" to Classification "L."

The following mines of the Red Jacket Coal Corporation in Size Group 26 are classified as follows: Mitchell Branch Mine, "J"; Junior Mine, "K"; #5 Mine, "N"; #6 Mine, "F"; #32 Top Mine, "M"; #32 Bottom Mine, "K."

The Secretary of the Commission is hereby directed to cause a copy of this Order to be included in the docket containing the record of the proceedings in the matter of the proposal of minimum prices by the District Boards for Districts Nos. 7 and 8 in General Docket No. 15, and shall cause a copy of this Order to be published forthwith in the FEDERAL REGISTER, and shall cause a copy hereof to be mailed to the Secretary of each District Board, to each code member in Districts Nos. 7 and 8, to the Consumers' Counsel, and to all parties who have filed their appearances in the hearing relating to the proposals submitted by the District Boards for Districts Nos. 7 and 8, and shall cause a copy hereof to be made available for inspection at the office of the Secretary of the Commission, Washington, D. C., and at the office of each Statistical Bureau of the Commission.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–483; Filed, February 10, 1939; 10:05 a. m.]

[1] 4 F. R. 307 DI.
[2] 4 F. R. 328 DI.

Notices

DEPARTMENT OF THE INTERIOR.

National Bituminous Coal Commission.

[Docket No. 4–FD]

APPLICATION OF SMOKELESS COAL CORPORATION FOR PROVISIONAL APPROVAL AS MARKETING AGENCY

PETITION FOR APPROVAL OF CHANGES IN FORMS OF CONTRACTS BETWEEN THE CORPORTATION AND PRODUCERS AND SUB-AGENTS

Notice and Order for Hearing

The petitioner above-named, having on the 25th day of January, 1939, filed its petition for approval of changes in forms of contracts between the corporation and producers and sub-agents, *Notice is hereby given* That the above-entitled matter is assigned for hearing before an Examiner of the Commission on the 1st day of March, 1939, at ten o'clock a. m., at the hearing room of the Commission, Walker Building, 734 15th Street, N. W., Washington, D. C., at which time and place interested parties will be afforded an opportunity to be heard.

The Secretary of the Commission is forthwith directed to mail a copy of this Notice of Hearing to the petitioner above-named, to the Secretary of each District Board, and to the Consumers' Counsel, and shall cause a copy to be published in the FEDERAL REGISTER.

A copy of the aforesaid petition is on file and available for inspection by interested parties at the office of the Secretary of the Commission.

By order of the Commission.

Dated at Washington, D. C., this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-488; Filed, February 10, 1939; 10:06 a. m.]

ORDER IN THE MATTER OF THE APPLICATIONS FOR EXEMPTION UNDER THE SECOND PARAGRAPH OF SECTION 4-A OF THE BITUMINOUS COAL ACT OF 1937

O & L Coal Co., Attica, Iowa (Docket No. 363-FD); Stub Coal Co., Bussey, Iowa (Docket No. 366-FD); Cedar Bluff Coal Co., Hamilton, Iowa (Docket No. 367-FD); Rowley Coal Co., Knoxville, Iowa (Docket No. 377-FD); Melcher Coal Co., Attica, Iowa (Docket No. 386-FD); Valley Forge Coal Co., Hamilton, Iowa (Docket No. 387-FD); Pike Coal Co., Des Moines, Iowa (Docket No. 395-FD); Standard Coal Co., Dallas, Iowa (Docket No. 397-FD); Oakdale Coal Co., Indianola, Iowa (Docket No. 398-FD); Hidden Hollow Coal Co., Hamilton, Iowa (Docket No. 400-FD); Walnut Valley Coal Co., Prairie City, Iowa (Docket No. 402-FD); National Coal Co., Marysville, Iowa (Docket No. 409-FD).

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing that the above named applicants having heretofore filed with the Commission their respective applications for exemption from the provisions of Section 4 and the first paragraph of Section 4-A of the Bituminous Coal Act of 1937; and

It further appearing that the above named applicants, by their attorney, have moved the Commission to dismiss, without prejudice, their applications for exemption;

Now, therefore, it is hereby ordered:

1. That the above named applications be and are hereby dismissed without prejudice to the right of any applicant to file at any future time an application for exemption pursuant to the provisions of Section 4-A of the Bituminous Coal Act of 1937, and in conformance with the Rules of Practice and Procedure before the Commission;

2. That the Secretary of the Commission is directed forthwith to mail a copy of this Order to each of the above named applicants, to the Consumers' Counsel, to the Secretary of each District Board, to the Commissioner of Internal Revenue, and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-480; Filed, February 10, 1939; 10:04 a. m.]

ORDER IN THE MATTER OF THE APPLICATIONS FOR EXEMPTION UNDER THE SECOND PARAGRAPH OF SECTION 4-A OF THE BITUMINOUS COAL ACT OF 1937

Carbon Hill Coal Co., Oskaloosa, Iowa (Docket No. 382-FD); Spavin Coal Co., Knoxville, Iowa (Docket No. 388-FD); Robert Payne & Sons Coal Co., Shawneetown, Illinois (Docket No. 510-FD); Berea Coal Co., Lexington, Kentucky (Docket No. 519-FD); Z. J. Elmore, doing business as Cahaba Coal Mining Co., and Cahaba Red Ash Coal Co., Birmingham, Alabama (Docket No. 526-FD).

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing that the above-named applicants having heretofore filed with the Commission their respective applications for exemption from the provisions of Section 4 and the first paragraph of Section 4-A of the Bituminous Coal Act of 1937; and

It further appearing that the above-named applicants have filed with the Commission their respective withdrawals, without prejudice, of their applications for exemption;

Now, therefore, it is hereby ordered:

1. That the withdrawals of the said applications for exemption from the provisions of Section 4-A and the first paragraph of Section 4-A filed by the above-named applicants, be and the same hereby are granted without prejudice to the right of any of the above-named applicants to file at any future time an application for exemption pursuant to the provisions of Section 4-A and without such withdrawals constituting a waiver of any exemption which might otherwise become effective during the pendency of a subsequent application; and

2. That the Secretary of the Commission is directed forthwith to mail a copy of this Order to each of the above-named applicants, to the Consumers' Counsel, to the Secretary of each District Board, to the Commissioner of Internal Revenue, and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-481; Filed, February 10, 1939; 10:04 a. m.]

[Docket No. 493-FD]

ORDER IN THE MATTER OF THE APPLICATION OF PATTON CLAY MANUFACTURING COMPANY, FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4-A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of Patton Clay Manufacturing Company, that applicant is the owner and producer of bituminous coal from a certain mine located in Chest Township, Cambria County, Pennsylvania, and that all of the bituminous coal produced at such mine is consumed by applicant.

Now, therefore, It is hereby ordered:

That the provisions of Section 4, Part II (1) of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by Patton Clay Manufacturing Company at its mine located in Chest Township, Cambria County, Pennsylvania, which is consumed by that company in the manufacture of clay products at its plant located at Patton, Pennsylvania, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-487; Filed, February 10, 1939; 10:06 a. m.]

[Docket No. 500–FD]

ORDER IN THE MATTER OF THE APPLICATION OF COLUMBIA FIRE BRICK COMPANY FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4–A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of Columbia Fire Brick Company, that applicant is the owner and producer of bituminous coal from a mine located in Dover Township, Tuscarawas County, Ohio, and that all of the bituminous coal produced at such mine is consumed by the applicant at its plant located on lot number 10 in Dover Township, Tuscarawas County, Ohio,

Now, therefore, It is hereby ordered:

That the provisions of Section 4, Part II (1), of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by Columbia Fire Brick Company at its mine located in Dover Township, Tuscarawas County, Ohio, which is consumed by that company at its plant located on lot number 10 in Dover Township, Tuscarawas County, Ohio, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureau of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–484; Filed, February 10, 1939; 10:05 a. m.]

[Docket No. 502–FD]

ORDER IN THE MATTER OF THE APPLICATION OF FEDERAL CLAY PRODUCT COMPANY FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission, held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4–A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of Federal Clay Product Company, that applicant is the owner and producer of bituminous coal from a mine located in Sandy Township, Tuscarawas County, Ohio, and that all of the bituminous coal produced at such mine is consumed by the applicant at its plant located in Mineral City, Ohio,

Now, therefore, It is hereby ordered:

That the provisions of Section 4, Part II (1), of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by Federal Clay Product Company at its mine located in Sandy Township, Tuscarawas County, Ohio, which is consumed by that company at its plant located in Mineral City, Ohio, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–482; Filed, February 10, 1939; 10:05 a. m.]

[Docket No. 538–FD]

ORDER IN THE MATTER OF THE APPLICATION OF THE SISTERS OF PROVIDENCE OF ST. MARY'S-OF-THE-WOODS, FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That pursuant to the provisions of an Act of Congress approved April 26, 1937, entitled "An Act to regulate interstate commerce in bituminous coal and for other purposes" (Public No. 48, 75th Cong., 1st Sess.), known as the Bituminous Coal Act of 1937, applicant, The Sisters of Providence of St. Marys-of-the-Woods, on the 14th day of November, 1938, filed with the Commission its application for exemption seeking to avail itself of the provisions of Section 4, Part II (1) of the Bituminous Coal Act of 1937 in so far as the same relates to the bituminous coal alleged to be produced and consumed by it, or produced and transported to itself for consumption by it in the generation of electricity and power used by it in connection with the operation of the church and college operated by the applicant, which application was filed by virtue of the provisions contained in the second paragraph of Section 4–A of the Act; and

It further appearing, After considering the allegations made in the verified application of The Sisters of Providence of St. Marys-of-the-Woods, that applicant is an Indiana corporation organized exclusively for religious and charitable purposes, and that it operates a church and school, doing business in the State of Indiana by virtue of the corporation laws of the State of Indiana; that applicant is a member of the Bituminous Coal Code; that applicant is the owner and producer of bituminous coal from a certain mine located adjacent to the college and church operated by it in Vigo County, Indiana; that all of the bituminous coal produced at such mine is consumed by applicant;

Now, therefore, It is hereby ordered:

That the provisions of Section 4, Part II (1) of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by The Sisters of Providence of St. Marys-of-the-Woods at its mine located adjacent to the college and church operated by it in Vigo County, Indiana, which is consumed by The Sisters of Providence of St. Marys-of-the-Woods in the generation of electricity and power used by it in connection with the operation of the church and college operated by the applicant, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are

afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–479; Filed, February 10, 1939; 10:04 a. m.]

ORDER IN THE MATTER OF THE APPLICATIONS FOR EXEMPTION UNDER THE SECOND PARAGRAPH OF SECTION 4–A OF THE BITUMINOUS COAL ACT OF 1937

Arthur Bolin, Peay, Tenn. (Docket No. 539–FD); E. C. Brock, Campaign, Tenn. (Docket No. 540–FD); Bob Crawford, Clifty, Tenn. (Docket No. 541–FD); Cumberland Mountain Coal Co., McMinnville, Tenn. (Docket No. 542–FD); Diamond Coal Mining Co., Knoxville, Tenn. (Docket No. 543–FD); Isoline Coal Co., Nashville, Tenn. (Docket No. 544–FD); Erman Meeks, Tracy City, Tenn. (Docket No. 545–FD); Alf Parker, Clifty, Tenn. (Docket No. 546–FD); R. W. Pinkleton (Blue Gem Coal Co.), Jacksboro, Tenn. (Docket No. 552–FD); Ben & Wm. Porter, Eastland, Tenn. (Docket No. 553–FD); Rocky River Coal & Lumber Co., Robinson Springs, Tenn. (Docket No. 544–FD); John Scott, Ravenscroft, Tenn. (Docket No. 555–FD); Clyde L. and R. S. Shelby, Clifty, Tenn. (Docket No. 556–FD); John M. Smith, Dunlap, Tenn. (Docket No. 557–FD); Tennessee Consolidated Coal Co., Tracy City, Tenn. (Docket No. 558–FD); Whitwell Smokeless Fuel Co., Whitwell, Tenn. (Docket No. 559–FD).

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

The above-named applicants having heretofore filed with the Commission their applications for exemption from the provisions of Section 4 and the first paragraph of Section 4–A of the Bituminous Coal Act of 1937, alleging that their transactions in coal are in intrastate commerce and do not directly affect interstate commerce in coal, and

It appearing, That the coal mines of said applicants are located in the State of Tennessee, and that the above-named applications were filed prior to the issuance by the Commission of an order subjecting transactions in coal in intrastate commerce in the State of Tennessee to the provisions of the Act on the ground that such transactions directly affect interstate commerce in coal, and that such an order has not yet been issued for the State of Tennessee, and that the applications for exemption are therefore, premature,

Now, therefore, It is hereby ordered:

That the above-named applications and each of them be and the same are hereby dismissed without prejudice.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to each of the applicants above named, or to their attorneys of record, to the Consumers' Counsel, to the Secretary of each District Board, to the Commissioner of Internal Revenue, and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission.

By order of the Commission.

Dated this 8th day of February 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–486; Filed, February 10, 1939; 10:06 a. m.]

[Docket No. 549–FD]

ORDER IN THE MATTER OF THE APPLICATION OF NORTH AMERICAN REFRACTORIES COMPANY FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4–A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of North American Refractories Company, that applicant is the owner and producer of bituminous coal from certain mines known as the Rowles Mine located in Pike Township, Clearfield County, Pennsylvania, and the Dover No. 2 Mine located in Tuscarawas County, Ohio; and that all of the bituminous coal produced at such mines is consumed by the applicant at its refractories manufacturing plants located in Curwensville and Lumber City, Pennsylvania, and in Strasburg, Ohio.

Now, therefore, It is hereby ordered:

That the provisions of Section 4, Part II (1) of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by North American Refractories Company at its mines located in Pike Township, Clearfield County, Pennsylvania, and Tuscarawas County, Ohio, which is consumed by that company at its refractories manufacturing plants located in Curwensville and Lumber City, Pennsylvania, and in Strasburg, Ohio, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39–489; Filed, February 10, 1939; 10:06 a. m.]

[Docket No. 567–FD]

ORDER IN THE MATTER OF THE APPLICATION OF W. H. DAUGHERTY AND SONS REFINING COMPANY FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4–A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of W. H. Daugherty and Sons Refining Company, that applicant is the owner and producer of bituminous coal from a certain mine located at Petrolia, Pennsylvania, and that all of the bituminous coal produced at such mine is consumed by the applicant at its oil refinery located at Petrolia, Pennsylvania,

Now, therefore, It is hereby ordered:

That the provisions of Section 4 Part II (1) of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by W. H. Daugherty and Sons Refining Company at its mine located at Petrolia, Pennsylvania, which is con-

sumed by that company at its oil refinery at Petrolia, Pennsylvania, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this Order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-485; Filed, February 10, 1939; 10:05 a. m.]

[Docket No. 594-FD]

ORDER IN THE MATTER OF THE APPLICATION OF GENERAL REFRACTORIES COMPANY FOR EXEMPTION

At a regular session of the National Bituminous Coal Commission, held in its offices in Washington, D. C., on the 8th day of February 1939.

It appearing, That the above named applicant having heretofore filed with the Commission its application for exemption from the provisions of Section 4 and the first paragraph of Section 4-A of the Bituminous Coal Act of 1937; and

It appearing, After considering the allegations made in the verified application of General Refractories Company, that applicant is the owner and producer of bituminous coal from a certain mine located at Salina, Westmoreland County, Pennsylvania; and that all of the bituminous coal produced at such mine is consumed by the applicant at its refractory located at Salina, Westmoreland County, Pennsylvania.

Now, therefore, It is hereby ordered:

That the provisions of Section 4 Part II (1) of the Bituminous Coal Act of 1937 do apply to the bituminous coal produced by General Refractories Company at its mine located at Salina, Westmoreland County, Pennsylvania, which is consumed by that company at its refractory located at Salina, Westmoreland County, Pennsylvania, and such coal shall not be deemed subject to the provisions of Section 4 of the Bituminous Coal Act of 1937.

Within fifteen (15) days from the date of this Order all interested parties are afforded the opportunity of filing a protest to this determination requesting a hearing on the application and protest. If no such protest be filed, this Order shall become effective fifteen (15) days from this date.

Applicant shall apply annually hereafter, and at such other times as the Commission may require, for renewal of this Order, and applicant shall file such accompanying reports as will enable the Commission to determine whether the facts as found in this Order continue to exist.

The Secretary of the Commission is directed forthwith to mail a copy of this order to the applicant, to the Consumers' Counsel, and the Secretary of each District Board; and shall cause a copy hereof to be filed and made available for inspection at each of the Statistical Bureaus of the Commission; and shall cause a copy hereof to be published in the FEDERAL REGISTER.

By order of the Commission.

Dated this 8th day of February, 1939.

[SEAL] F. WITCHER MCCULLOUGH,
Secretary.

[F. R. Doc. 39-490; Filed, February 10, 1939; 10:07 a. m.]

DEPARTMENT OF AGRICULTURE.

Agricultural Adjustment Administration.

[Docket No. A-90 O-90]

NOTICE OF HEARING WITH RESPECT TO PROPOSED MARKETING AGREEMENT AND ORDER REGULATING HANDLING OF FRESH BARTLETT PEARS, PLUMS, PEACHES, APRICOTS, AND CHERRIES GROWN IN THE STATE OF CALIFORNIA

Whereas, under Public Act No. 10, 73rd Congress, as amended, and as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, (hereinafter referred to as the "act") notice of hearing is required in connection with a proposed marketing agreement or a proposed order, and the General Regulations, Series A, No. 1, as amended, of the Agricultural Adjustment Administration, United States Department of Agriculture, provide for such notice; and

Whereas, the Secretary of Agriculture of the United States has reason to believe that the execution of a marketing agreement and the issuance of an order will tend to effectuate the declared policy of said act with respect to such handling of fresh Bartlett pears, plums, peaches, apricots, and cherries grown in the State of California as is in the current of interstate or foreign commerce or which directly burdens, obstructs, or affects interstate or foreign commerce;

Now, therefore, pursuant to the said act and said general regulations, notice is hereby given of a hearing to be held on a proposed marketing agreement and a proposed order regulating such handling of fresh Bartlett pears, plums, peaches, apricots, and cherries grown in the State of California, in the Auditorium, Native Sons Building, 11th and J Streets, Sacramento, California, on February 27, 1939, at 9:30 a. m., p. s. t.

This public hearing is for the purpose of receiving evidence as to the general economic conditions which may necessitate regulation in order to effectuate the declared policy of the act and as to the specific provisions which a marketing agreement and order should contain.

The proposed marketing agreement and the proposed order each provides, in similar terms, a plan for the regulation of such handling of the aforesaid fresh Bartlett pears, plums, peaches, apricots, and cherries grown in the State of California as is in the current of interstate or foreign commerce or which directly burdens, obstructs, or affects interstate or foreign commerce. Among other matters relating to such regulation, the proposed marketing agreement and order provide for: (a) the establishment of a Control Committee consisting of twenty-five members, thirteen of whom shall represent producers and twelve of whom shall represent handlers, and a Commodity Committee for each of the fruits included in the proposed marketing agreement and order; (b) regulation of shipments by grade or size, or both, and inspection of shipments by a duly authorized representative of an approved inspection service during periods when regulation is in effect; (c) prohibition of unfair trade practices; (d) regulation of daily shipments; (e) regulation of distribution of fruit in particular controlled marketing areas; (f) establishment of a surplus pool; (g) limitation of shipments by period proration; (h) levying of assessments to cover expenses of administration; and (i) reports to the Committees by handlers.

Copies of the proposed marketing agreement and proposed order may be procured from the Hearing Clerk, Office of the Solicitor, Room 0316, South Building, United States Department of Agriculture, Washington, D. C., and said proposed marketing agreement and order may be inspected in said Room 0316, South Building.

[SEAL] H. A. WALLACE,
Secretary of Agriculture.

Dated: February 10, 1939.

[F. R. Doc. 39-495; Filed, February 10, 1939; 12:45 p. m.]

SECURITIES AND EXCHANGE COMMISSION.

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commisison held at its

office in the City of Washington, D. C., on the 7th day of February 1939.

[File No. 1-2283]

IN THE MATTER OF HALIFAX TONOPAH MINING COMPANY ASSESSABLE CAPITAL STOCK, PAR VALUE 10¢

ORDER SETTING HEARING ON APPLICATION TO STRIKE FROM LISTING AND REGISTRATION

The Salt Lake Stock Exchange, pursuant to Section 12 (d) of the Securities Exchange Act of 1934, as amended, and Rule X-12D2-1 (b) promulgated thereunder, having made application to strike from listing and registration the Assessable Capital Stock, Par Value 10¢, of Halifax Tonopah Mining Company; and

The Commission deeming it necessary for the protection of investors that a hearing be held in this matter at which all interested persons be given an opportunity to be head;

It is ordered, That the matter be set down for hearing at 10 A. M. on Thursday, March 9, 1939, at the office of the Securities and Exchange Commission, 1706 Welton Street, Denver, Colorado, and continue thereafter at such times and places as the Commission or its ofcer herein designated shall determine, and that general notice thereof be given; and

It is further ordered, That John G. Clarkson, an officer of the Commission, be and he hereby is designated to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda or other records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith authorized by law.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 39-492; Filed, February 10, 1939; 11:14 a. m.]

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission held at its office in the City of Washington, D. C., on the 8th day of February 1939.

[File No. 1-488]

IN THE MATTER OF HOLLAND FURNACE COMPANY (A MICHIGAN CORPORATION) COMMON STOCK, NO PAR VALUE, AND $5 CUMULATIVE CONVERTIBLE PREFERRED STOCK, NO PAR VALUE

ORDER SETTING HEARING ON APPLICATION TO STRIKE FROM LISTING AND REGISTRATION

The New York Stock Exchange pursuant to Section 12 (d) of the Securities Exchange Act of 1934, as amended, and Rule X-12D2-1 (b) promulgated thereunder, having made application to strike from listing and registration the Common Stock, No Par Value, and $5 Cumulative Convertible Preferred Stock, No Par Value, of Holland Furnace Company (A Michigan Corporation); and

The Commission deeming it necessary for the protection of investors that a hearing be held in this matter at which all interested persons be given an opportunity to be heard;

It is ordered, That the matter be set down for hearing at 10 a. m. on Monday, March 20, 1939, at the office of the Securities and Exchange Commission, 120 Broadway, New York City, and continue thereafter at such times and places as the Commission or its officer herein designated shall determine, and that general notice thereof be given; and

It is further ordered, That A. C. Humphreys, an officer of the Commission, be and he hereby is designated to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda or other records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith authorized by law.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 39-494; Filed, February 10, 1939; 11:14 a. m.]

United States of America—Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission held at its office in the City of Washington, D. C., on the 8th day of February 1939.

[File No. 1-2382]

IN THE MATTER OF APPLICATION OF THE NEW YORK STOCK EXCHANGE TO STRIKE FROM LISTING AND REGISTRATION THE THREE-YEAR 6% NOTES, DUE OCTOBER 1, 1938, OF THE NEW YORK, CHICAGO AND ST. LOUIS RAILROAD COMPANY

ORDER SETTING HEARING ON APPLICATION TO STRIKE FROM LISTING AND REGISTRATION

The New York Stock Exchange pursuant to Section 12 (d) of the Securities Exchange Act of 1934, as amended, and Rule X-12D2-1 (b) promulgated thereunder, having made application to strike from listing and registration the Three-Year 6% Notes, due October 1, 1938, of The New York, Chicago and St. Louis Railroad Company; and

The Commission deeming it necessary for the protection of investors that a hearing be held in this matter at which all interested persons be given an opportunity to be heard;

It is ordered, That the matter be set down for hearing at 10 A. M. on Tuesday, March 7, 1939, in Room 1101, Securities and Exchange Commission Bldg., 1778 Pennsylvania Ave., N. W., Washington, D. C., and continue thereafter at such times and places as the Commission or its officer herein designated shall determine, and that general notice thereof be given; and

It is further ordered, That James G. Ewell, an officer of the Commission, be and he hereby is designated to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda or other records deemed relevant or material to the inquiry, and to perform all other duties in connection therewith authorized by law.

By the Commission.

[SEAL] FRANCIS P. BRASSOR, *Secretary.*

[F. R. Doc. 39-493; Filed, February 10, 1939; 11:14 a. m.]